BANK OWNERSHIPS AND SIZE ON AUDIT QUALITY: AN EMPIRICAL STUDY IN INDONESIA

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Abstract:

Bank is the heart of the nation's economy and the major supporter of the economy with its role as the financial intermediary. A reliable audit report will be a very useful information for various parties in order to provide assurance that the financial statements presented in accordance with applied accounting standards. The purpose of this study is to investigate the effects of bank ownerships and its size on audit quality. At the same time this study also investigate the effect of bank ownerships on company size. The research found that institutional ownership did not have a significant effect on audit quality, managerial ownership did not have significant effect on audit quality, institutional ownership did not have a significant effect on company size and managerial ownership did not have a significant effect on company size, while company size has a significant effect on audit quality,

Keywords: *bank ownerships, company size, audit quality*.

Introduction

Indonesia second crisis was the high inflation in the 1970s, it was because the amount of money in circulation and the end of the food crisis in 1972. The inflation rate peaked at 41% in 1974, also devalued rupiah by 50% in 1978. Furthermore, in September 1984 Indonesia experienced a banking crisis, which originated from banking deregulation in 1983 that forced the state banks to mobilize their funds and bear the risk of bad debts, and was free to determine the interest rate, so lasted until the economic crisis that began in 1997. Again between the years 1990-1995 Indonesian economy several times crashed from time to time until 1998 Indonesia experienced a very serious economic crisis until the economy damaged the joints of economics (Tambunan, 1998). The definition of during relatively stable economic condition in Indonesia at this study were in the era after the economic crisis of 1998, so that the data processed in this study was taken for the year of 2001 to 2012.

The relationship between the principals as the owner and managers as agent (referred to as an agency relationship) is seen as a very important relationship to the company, namely as a contract from the principal parties to the agent who carry out a service or work for the interests of the principal and for that reason the principal delegates some authority to the agent (Jensen and Meckling 1976). The Efforts made by the principal in order to perform the functions of management as agent in accordance with the interests of the owners is to put a good controlling system, including a system of reporting is in accordance with the applicable reporting standards, and finally where the appointed auditors in the assignment of the audit will give the qualified audit results.

The collapse of Enron, which had involved the big five public accounting firms, Arthur Andersen and also the downfall of WorldCom in the United States, have been Attributed to poor audit quality associated with a perceived lack of auditor independence (Nurhayati, 2002). Reviews these were alleged as audit failures deemed to have occurred because auditors either failed to detect or report material errors/ misstatements in the financial statements.

Managerial ownership freely interpreted as the conditions where shares that is owned by the managers and or the directors of an entity in itself. Managerial ownership can bring together the interests of managers with shareholders so that works out to be a mechanism that can reduce agency problems between managers and the owners (Jensen and Meckling, 1976). It is based on the idea that an increase in the proportion of shares owned by the manager will reduce the tendency of managers to perform redundant actions in the interests of the manager alone. When the proportion of managerial ownership is high enough then the managers will feel involved have companies that will try to reduce actions that could hurt the company. Thus it will unite the interests of managers with shareholders, this condition will give positive impact on the performance of the company and support the viability of the company, The supervisors and also including the audit committee will look for a qualified auditor that causing a tendency to produce quality audit reports for the company.

Institutional ownership is the percentage of voting rights held by institutions (Beiner *et al.*, 2006; Alipour 2013). With the existence of institutional ownership as by external parties owners such as insurance companies, banks, investment companies, and ownership by other institutions can encourage closer performance control to the company management, conducted surveillance efforts including the selection of credible and competent auditors that it will produce a higher quality audit report.

It is the reason the institutional ownership of equity has grown rapidly in recent years. As it says there is an increasing power of institutional investors in the market and their influence over corporate policies. The institutions usually hold blocks of securities and continuously monitor corporate management (Nussboun & Dobrzynski 1987).

On the other hand that the large-sized companies are more likely to have the ability to overcome the problems they face when compared with small company, big companies who facing financial problems will be easier to seek funding, as investor confidence to those larger than the small ones, because according to the investors, the larger companies more capable to manage its money properly. The above considerations also give to the auditors to take more attention to the smaller companies than in large-sized enterprises in the granting of going concern audit opinion, thus the quality of the audit (in this study diproxied by going concern audit opinion) more visible in small companies (Stocken 2000; Mutchler 1986; Fijriantoro 2010). In this case it can be said that the size of the company deal (have correlation) with the results given the auditor's audit quality.

This study aims to find out the influence of ownership, company size on audit quality in Indonesian banking industry. Yet to enrich the results, this study also try to find out the effect of ownership on the company size in Indonesian banking industry by taking the time span of the data in relatively stable economic situation (the study year 2001-2012). To limit the coverage, this research estimates audit quality by using measures from inside audit firms which is the issue of going-concern opinion as Jackson *et al*., (2008) applied, also because of the quality of the audit results is determined by the outcomes of a report/ opinion of the auditor itself.

Research Questions

Based on the above descriptions and background, then the research questions for this study are:

1. Is there any significant effect of company size on audit quality in Indonesia banking industry?
2. Is there any significant effect of institusional ownership on audit quality in Indonesia banking industry?
3. Is there any significant effect of managerial ownership on audit quality in Indonesia banking industry?
4. Is there any significant effect of institusional ownership on company size in Indonesia banking industry?
5. Is there any significant effect of managerial ownership on company size in Indonesia banking industry?

Method of Study, Data and Originality

This research is a descriptive study, in which the author describes the object under study in accordance with the actual situation without treatment and intervention with the object of study, this research uses statistics as a tool in order to assist in taking conclusion, it is using partial least square regression approach (PLS) path analysis gives more openness in providing data processing requirements in the sense that the terms classical assumptions and certain distributions as ordinary least squares approach is no longer needed (Latan and Ghozali 2012, Jogianto 2009).

PLS regression seeking for component of the better predictors for the object, under study with PLS regression it will be more easier terms in the number of independent variables, that is to say if the number of independent variables > the number of observations than the degree of freedom will be negative so that ordinary least squared (OLS regression) cannot resolve the equation, but with PLS this can be resolved (Ghozali 2013), Another advantage of the PLS approach is that this approach can still be used in the data with a small sample but it gives good results. Thus the outcomes of the study will provide useful results and practical objectives. It says further that using partial least square approach was not much hinted before processing the data (eg requirements in classical assuming) as usual when the covariance approach based / ordinary least square but still can find the powerful results (Wold, 1985), so the results of this processing will provide the answers to the effect of ownership and company size on audit quality during the economic stable in Indonesia.

The study population is the entire banking companies listed on the Stock Exchange that the research study sample was banking companies published audited financial statements by an independent auditor for the period ending 31 December 2001 to 2012, both of which give a going concern audit opinion or not giving going concern audit opinion by an independent auditor. Secondary data were obtained from the official website of the Stock Exchange that is www.idx.co.id and www.sahamok.com in the form of annual report and the audited financial statements banking companies listed in Indonesia Stock Exchange.

The models in this study based on previous theories builded and it is unique in terms of the writer did not find yet the study specified the audit quality during the economic stable in Indonesia and at the same time using partial least squred path analysis.

Basic of Theory

Audit quality firstly defined as the joint probability that auditors will discover and report a breach in their clients' accounting system (DeAngelo 1981). No single agreed definition of audit quality serves as a standard. Researchers established several proxy variables for testing, including Leonora at al., (2012:3-4)

using fraudulent financial reports as proxy for audit quality. While research of Myers et al., (2003) using tenur public accounting firms and audit partners as a proxy for audit quality. Jackson *et al*., (2008) proxied audit quality propensity to issue a going-concern report and the level of discretionary accruals. While Siregar at al., (2012) and also Lawrence et al., (2011) using discretionary accruals in research to measure the quality of the audit, Rustiarini (2012:11) in his research proxied audit quality with smooth accrual. Zunaidah at al., (2013) using the amount of audit fees paid as a measurement of audit quality, while Simunic and Stein (1996) and also DeFond (1992) using auditors size as the size of audit quality. While Palmrose, (1988) and also Heninger, (2001) using the auditor litigation as a measure of audit quality. Simunic and Stein (1996) and also DeFond (1992) using the auditor size as a measure of audit quality. Different again with Palmrose, (1988) and also Heninger, (2001) using the auditor litigation as a measure of audit quality. This study estimate audit quality by using measures from audit firms inside the which is the issue of going-concern opinion as Jackson et al., (2008) applied.

Company Size and Audit Quality

The size of the company is a scale that can classify companies into large and small companies in a variety of ways, including total assets, the value of the stock market, the average level of sales, and sales amount. Basically the only firm size are divided into large enterprises, medium and small companies.

At the time of the company face financial problems in funding, than the alternatives to do is through loans from outside parties or issuing shares for the financing. Large companies are more likely to have the ability to overcome problems like these, large companies easier to seek funding for a more credible, Investors also found larger companies have more ability to manage their money properly.

On the other hand, auditors also view that the small company should receive more attention in connection with the provision of audit opinion going concern, thus the quality of the audit (which proxied with goingconcern audit opinion) more clearly have the relationship with the size of the company (Stocken 2000; Mutchler 1986; Fijriantoro 2010; Arsianto & Rahardjo 2013), in this case it can be said that the size of the company will deal with the results of audit quality given by the auditor.

Ownership and Audit Quality

Managerial ownership in a general sense are shares owned by the managers and or the directors of an entity itself, such ownership can bring together the interests of managers with shareholders so that works out to be a mechanism that can reduce agency problems between managers and the owners (Jensen and Meckling, 1976). At the time of managerial ownership is high then the managers of the company will perform its functions better, with better coordination with other functions including the audit committee and the appointed auditors so that it will provide a better audit process in generating output of audit quality. In a study conducted in British insurance companies found that there are significant proportions of non-executives directors (which is seen as an independent condition) on the quality of the audit result while it also found that there was no correlation between managerial ownership on the quality of the audit result, namely ownership by members of the board and CEO of the company with the quality of the audit results (O'Sullivan and Diacon, 2003). Another view also found that managerial ownership can reduce the agency conflict between managers and shareholders, managers will feel a company so the existence of the company will be retained and the company's development will be done by increasing corporate control. Thus, the greater the proportion of managerial ownership, the smaller the possibility of receiving a going concern audit opinion. Linoputri (2010) shows the great influence of managerial ownership of the possibility of going concern audit opinion by the auditor in the company, the greater the managerial ownership, the less likely the auditor provides going concern audit opinion on the company.

Further research found that manager owners have an incentive to reduce associated agency costs by providing high audit quality. A high audit quality should thus be increasing as managerial ownership decreases. A related agency problem is that of entrenchment whereby managers, by virtue of their increased voting power, have increasing power to shirk and procure perquisites at shareholders' expense. The associated increasing agency risk implies that, when the risk of entrenchment decreases, the need, and thus provision, of high audit quality should also decrease. Based on these arguments, and following prior empirical research, posited and found that at low and high levels of managerial ownership (below 5% and above 25%), where entrenchment is not increasing, audit quality is decreasing in managerial ownership. At intermediate levels, where entrenchment arguably does increase, it is unclear which effect (divergence of interests or entrenchment) dominates (Kane and Velury 2005).

Institutional ownership is the percentage of voting rights held by institutions (Beiner et al., 2006; Alipour 2013). With the existence of institutional ownership as ownership by external parties such as insurance companies, banks, investment companies, and ownership by other institutions can encourage closer scrutiny.

At a high level of institutional ownership will improve the efficiency of the use of corporate assets, creating the optimal supervision of management performance, helping management carry out its responsibilities in accordance with the expected investor or better than expected, because of stock ownership represents an authority that could be used to support or vice versa on the performance of the management, the management of the company that made more professional, the control system will tend to be better prepared and audit committees that are less tied to the company or are seen as more independent will tend to be more awakened (Dorothy and David, 2003). This situation will lead to the selection of an independent auditor more and more competent in engagement and assignment so that the tendency of producing output that is more reliable audit opinion and the quality will be higher.

Ownership and Size

As has already been mentioned that the size of the company as a scale that can classify companies into large and small companies in a variety of ways including total assets, the value of the stock market, the average level of sales, and total sales. The company's growth also indicates the company's ability to maintain its business continuity. The companies that grow show activities in the company's operations go according to plans made, so that the companies can maintain its economic position and survival, while companies with a negative growth indicates a greater tendency toward bankruptcy (Altman in Widyantari 2011), companies with good and sustainable growth will increasing the size of the various scales of measurement.

Ownership structure could be considered to be one of the factor that can determine the performance of companies and further to the growth and size of the company. With the difference of company ownership means the management and regulation in the determination of the company can also be different. With the presence of management as representatives of business owners in running the business will provide opportunities for management itself acts and using methods as an alternative that will provide benefit for him as an agent and not solely for the benefit of owners, this opportunistic situation can be minimized by effective monitoring (Herawaty, 2008). One way to become better monitoring function is to consider an appropriate ownership structure, because the ownership structure will able to influence investment decisions and that further efforts will have an impact growth (Haruman, 2006), with adequate growth will impact on the size for the company itself.

From the above descriptions, the hypothesis of this study constructed as follows:

1. Company size has a significant effect on audit quality in Indonesia banking industry.
2. Institusional ownership has a significant effect on audit quality in Indonesia banking industry.
3. Managerial ownership has a significant effect on audit quality in Indonesia banking industry.
4. Institusional ownership has a significant effect on company size in Indonesia banking industry.
5. Managerial ownership has a significant effect on company size in Indonesia banking industry.

The Analysis

The analysis of this study includes descriptive statistic and statistical hypothesis testing in order to be able to answer the hypothesis that has been proposed.

Descriptive Statistics

There were 38 banking companies listed in the Jakarta Stock Exchange (JSX) in the period 2001-2012, there were 6 delisted banks taken out as research sample, also 17 other banks taken out as reseacrh sample it was because these banks were new entry in JSX listing at the time of observation period, so there were 15 banks taken as sample in this study. With the years of research 2001 up to 2012 then there were 180 year observational datas. The statistical descriptive results shown the mean of audit quality was low, namely that from all observation yearlong there was only 5% of the audit results with going concern opinion. Shares that held by managerials only 3.29%, while institutional ownership of 70.89%, such ownership may impact on the ability to monitor management as agent in carrying out a better responsibilities. While the rest of the bank shares ownership were on the other third parties. For the size of the company indicated that the mean value of total assets for the object under this study was 21.389.986 (million rupiahs), with a minimum value of 274.989 (million rupiahs) and a maximum value of 440.970.898 (million rupiahs), which indicated there was a very large variability for bank size (see table 1).

Table 1
Descriptive Statistics

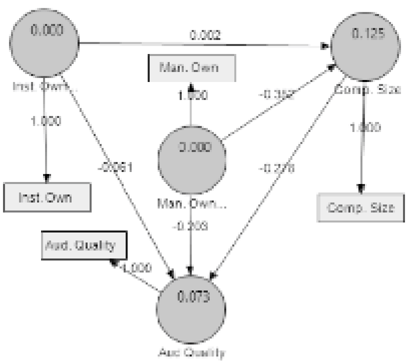
	N	Minimum	Maximum	Mean	Std. Deviation
Audit Quality	180	0	1	.05	.219
Managerial Ownership	180	.0000	55.8000	3.292989	11.9515354
Institusional Ownership	180	.0000	99.9960	70.886100	25.2707892
Company Size (million Rups)	180	274,989	440,970,898	21,389,986	77,967,314
Valid N (listwise)	180				

Sources: statistical output with spss v.20

Outer Model Test (Measurement Model)

The above figure 1 and Table 2 below answered whether datas used in this study feasible to be proceeded to the next stage.

Figure 1
Outer Model Test



Source: PLS figure output

From the above figure found that the entire loading factors was > 0.7 which mean it has a qualified validity and with the value of average variance extracted and Cronbachs Alpha were > 0.5 (see also table below), which means that the model was eligible to be processed further for statistical hypothesis test (Latan and Ghozali 2012).

Table 2
Overview Result

	AVE	Composite Reliability	R Square	Cronbachs Alpha
Audit Quality	1.000000	1.000000	0.073413	1.000000
Company Size	1.000000	1.000000	0.125244	1.000000
Institusional Ownership	1.000000	1.000000		1.000000
Managerial Ownership	1.000000	1.000000		1.000000

Source: statistical PLS output

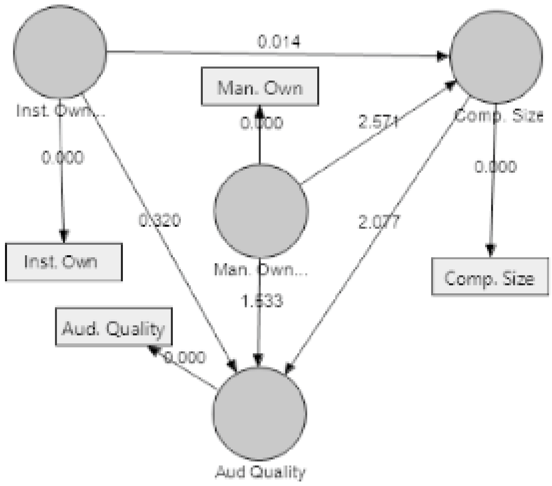
Inner Model Test (Path Model)

After going through the outer models test and shown that the datas were qualified and valid then the correlational testing among variables can be proceeded and at this stage of hypothesis testing can also be done. This hypothesis testing using significance level (α) of 5% and based on the rule of thumb inner evaluation models that the correlational between variables will be declared significant if the t-statistics > 1.96 (Latan and Ghozali 2012). Path testing models with PLS approach resulted that only two hypotheses were accepted, namely:

1. Hypothesis 1: which is, there is a significant effect of Company size on audit quality in Indonesia banking industry.
2. Hypothesis 5: which is, there is a significant effect of managerial ownership on company size in Indonesia banking industry.

Managerial ownership will minimize agency conflict in company so that the supervisory and controlling functions would more effectively applied, companies with a good supervisory function would be able to improve its performance and impact both on the growth and size of its company. Companies with a relatively larger size have a smaller tendency to get the results of going-concern audit opinion because auditors consider that the large company have a better ability to overcome the problems (including financial issues) that they faced.

Figure 2. Inner Model Test



Source: PLS figure output

Table 3

Path Coefficients (Mean, STDEV, T-Values)

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	Standard Error (STERR)	T Statistics (|O/STERR|)	Hypotesis (Accepted/ Rejected)
Company Size -> Audit Quality	-0.277554	-0.252466	0.133616	0.133616	2.077250	Accepted
Institusional Ownership -> Audit Quality	-0.060969	-0.078526	0.190733	0.190733	0.319655	Rejected
Institusional Ownership -> Company Size	0.002417	0.018183	0.169301	0.169301	0.014279	Rejected
Managerial Ownership -> Audit Quality	-0.203485	-0.199998	0.132694	0.132694	1.533492	Rejected
Managerial Ownership -> Company Size	-0.352234	-0.333694	0.136989	0.136989	2.571265	Accepted

Source: statistical PLS output

Conclusion and Management Interpretation

From 15 banks as research sample in this study there were 180 year datas observation, statistical result showed a mean value of audit quality that was proxied by going-concern opinion was 5% or at low level, This shown that in the stable economics condition going concern audit opinion issue would not became an attractive to the auditor's attention, This research support research conducted by Nolan which stating that the issues going concern audit opinion increased under crisis economic situation (Nolan: 2009). Although banking business sustainability can not be considered equal or in one uniformity between one bank to another bank particularly the data shown that the bank size variability in Indonesia was very large, it was the minimum value of 274.989 (million rupiahs) and a maximum value of 440.970.898 (millions rupiahs).

From statistical test concluded that there was significant effect of managerial ownership on company size in Indonesia banking industry. Such managerial ownership would mitigate the agency conflicts so that the company supervisory function more effectively carried, the nature or opportunistic manner of managers would reduced because managers as at the time also as the owners so that they would function them self to optimized company results and achievements, those managers would carry out managerial functions properly and thus those circumstance impacted for increasing both to the growth and the size of the company (this is in line with findings of Haruman 2006). Further finding that there was significant effect of company size on audit quality in Indonesia banking industry (agreed with Mutchler dalam Fijriantoro 2010; Arsianto & Rahardjo 2013). Which implies that the presence of managerial ownership in Indonesia bank have affected the increasing in the size of the bank and the bank's size also has affected the provision of banking going concern audit opinion, so that managerial ownership required as an important attention in Indonesia banking companies.

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