

The Effect of KAP Rotation, Audit Tenure and Company Size on Audit Quality in Manufacturing Companies

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Abstract

The research has a purpose to examine how audit quality is affected by KAP rotation, audit tenure, and firm size. Logistic regression analysis was used to process the data and purposive sampling technique was used to process the sample selection. With this technique, 166 manufacturing companies on the IDX in 2019-2021 have met the criteria in this study. The hypothesis was tested, and the results show that KAP rotation and audit tenure have no effect on audit quality. Nevertheless audit quality can be influenced by the company's size.

Type of Paper: Empirical

Keywords: KAP Rotation; Audit Tenure; Company Size; Audit Quality

1. Introduction

The likelihood that an auditor will find errors in a company's accounting system and report them is the definition of audit quality (DeAngelo, 1981). Audit quality is the auditor will not give an unqualified opinion in financial statements that contain material errors (Lee, Liu, Wang, 1999 in Tandiontong, 2016). Meanwhile, according to Wallace, (1980) in Watkins et. al., (2004) audit quality is known by reducing bias and increasing fineness in accounting data.

Management is responsible for the financial statements, namely conveying information to the owner about the state of the company. However, management often conveys information that is not the same as the situation that actually occurs in the company, resulting in asymmetric information, which causes agency problems. According to Tandiontong, (2016) Agency problems are problems that may arise between the principal and management, such as management having conflicting personal interests and can harm the principal. To reduce agency problems in the company, an independent party, more commonly referred to as an independent auditor, is needed to deal with this problem (Tandiontong, 2016). Auditors are expected to find fraud in order to make decisions based on published financial audit reports. Audit quality is very important for stakeholders so that the existence of auditors who are independent parties is expected to protect the interests of shareholders and creditors. Auditors are required to have an obligation to provide information about the company's performance openly and honestly. Audit quality in Indonesia has been regulated in the Decree of the Executive Board of the Indonesian Institute of Certified Public Accountants Number 4 of 2018 related to the Audit Quality Indicator Guidelines at KAP. The Audit Quality Indicator itself can be interpreted as an index that can enable Public Accountants to produce high quality audits that comply with professional standards, applicable regulations and codes of ethics. This Indicator Guide is determined by IAPI, with the aim of serving as a reference in improving the quality of audit services by determining audit quality indices that are aligned with the level of KAP in Indonesia.

In early 2020, the government issued PP No. 21 in 2020 regarding large-scale social restrictions to accelerate the settlement of Corona Virus Disease 2019 (COVID-19). Large-scale social restrictions are carried out in several regions of Indonesia including companies listed on the IDX. With these regulations, the auditors experience obstacles in collecting audit evidence. However, auditors still have to maintain audit quality. With the existence of Social Distancing, IAPI has established a new regulation, namely the Technical Newsflash Auditor's response to the COVID 2020 Pandemic. In this regulation, the engagement team or auditors must adjust the audit approach to the current situation. And the regulation also explains that auditors are advised to explore alternative procedures to make it easier to find audit evidence. With the completion of the audit, the auditor requires more time (past the specified deadline). So that auditors need to delay issuing their audit reports, and communicate with management and other parties who are responsible for this.

One example of an audit quality case that was widely discussed in 2018 was the case of PT Garuda Indonesia (Persero). AP Kasner Sirumapea from the Public Accounting Firm (KAP) Tanubrata, Sutanto, Fahmi, Bambang, & Rekan who examined its financial statements.

Previously, the Commissioners of PT Garuda Indonesia Tbk, namely Dony Oskaria and Chairal Tanjung, were debated for refusing to sign the approval of the 2018 Financial Statements. It is known that the two commissioners have different opinions on recording transactions with Mahata. In fact, until the end of 2018 there were no incoming payment transactions from Mahata. So the Indonesian Ministry of Finance said that the three errors were caused by the Public Accountant's carelessness in auditing the financial statements of PT Garuda Indonesia Tbk. for the 2018 period. The Public Accountant is known to have violated SA 315 related to "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment", SA 500 related to "Audit Evidence", SA 560 related to "Subsequent Events" to get sanctions in the form of license suspension in twelve months based on (KMK.No.312/KM.1/2019 dated 27 June 2019). The Public Accounting Firm handling the annual report examination is also subject to a written warning and is obliged to make revisions to the KAP Quality Control System and a review conducted by BDO International Limited (Letter No.S-210/MK.1PPPK/2019 dated 26 June 2019) to KAP Tanubrata, Sutanto, Fahmi, Bambang & Partners.

Palalangan et al. (2017) defines audit quality as the value or results of an audit activity process that is in line with the standard provisions and policies set and becomes a reference for the duties and responsibilities of auditors. In general, in addition to internal aspects that influence audit quality, external aspects such as audit tenure and KAP rotation also influence it. KAP rotation must be applied as an effort to keep auditors and clients from getting too close. If the company rotates more frequently, it can be assumed that the client does not have a close relationship with the auditor so that it can prevent auditors from having problems with their independence. However, if rotation is never done by the company, it will allow the auditor to develop a close relationship, which will jeopardise the auditor's objectivity and independence. To avoid closer ties between an auditor and auditee, PMK number 17/PMK.01/2008 was issued. This regulation regulates engagement restrictions, namely, for KAP the engagement limit is 3 (three) consecutive financial years while for KAP the engagement limit is 6 (six) consecutive financial years. With the rotation of KAP, it is expected that auditors produce quality audits. In the findings of Palalangan et al. (2017) prove that audit quality is not affected by audit rotation. In line with the findings (Aldona & Rina Trisnawati, 2018), (Berikang et al., 2018), (Ardhityanto, 2020) which also reveal that KAP rotation has no significant effect on audit quality. Auditors who are professional, independent in carrying out their duties have no influence on audit quality despite audit rotation. This is because an auditor maintains the good name of the KAP where he works by carrying out his duties optimally.

Audit tenure can also be referred to as an audit period which has the meaning as a time span in the creation of an auditor / KAP relationship with its clients in the implementation of ongoing audit activities, measured in years (Aldona & Trisnawati, 2018). Research (Hasanah & Putri, 2018), (Nurintiati & Purwanto, 2017) found that audit tenure has an influence on audit quality. This means that audit tenure that lasts a long time has a significant effect on audit quality.

Company size has a relationship with audit quality. Usually companies that have a large size will receive more attention by the media on the other hand companies with smaller sizes are assumed

to have weak information and checks, this results in shareholders paying less attention to this (Berikang et al., 2018). So that small companies can have quality audit quality, while increasing the audit quality of large companies has no effect because it has quality control. So that large companies tend to determine the services of large auditors who are experienced, independent and have a good image. Company size has been researched by several researchers, such as in research by Febriyanti & Mertha (2014), (Basworo et al., 2021), (Darya & Puspitasari, 2017) showing that there is an effect of company size on audit quality. The resulting audit quality increases with company size because large-scale companies will work hard to maintain a good name for the public interest. However, in contrast to Paramita & Latrini's (2015) research, it shows that company size does not affect audit quality.

The importance of conducting this research is to be able to know and examine how the application of regulations regarding the obligation to rotate KAP and the determination of the audit engagement period limit in the field with the aim of being able to present audit reports that have good quality and the information provided is reliable for various interests. As well as examining how the performance of large KAPs in realising superior audit quality than the audit quality of small KAPs. Based on this information, the researcher wants to research using the title "The Effect of KAP Rotation, Audit Tenure, and Company Size on Audit Quality in Manufacturing Companies".

2. Literature Review

Agency Theory

In 1976, Michael C. Jensen and William H. Meckling developed agency theory. According to Jensen & William H. Meckling (1976), agency relationships arise when one or more people (principals) work with other people (agents) with the aim of performing services and further mandating power in decision making. This theory describes the relationship between agents and principals, in which shareholders and company owners become principals and management becomes agents (Basworo et al., 2021). Agency theory builds a theory based on the availability of asymmetric information between the information advantages of management (agent) and owners (principal). To ensure that the financial statements are reliable, the principal requires an external party to audit the financial statements, where the agent is accountable to the principal. Through the financial statements, a third party, namely the auditor, is required to monitor management performance in accordance with the principal's interests and to assess the performance of managers and provide incentives such as shares to managers so that the needs of investors and managers can be aligned. The auditor must act as an independent party, so that the audit results are of high quality (Darya & Puspitasari, 2017).

Signalling Theory

Spence (1973) has stated regarding signalling theory that the sender (data owner) shares a signal or signal in the form of data that reflects the state of an industry that is useful for the recipient (investor). The data submitted can affect investors' decision making in investing. Quality data (information) in financial statements can be seen from several points of view, including accuracy, relevance, data completeness and time accuracy. When auditing financial statements,

auditors play an important role in order to obtain audit quality. Zahmatkesh & Rezazadeh (2017) assume that auditors can produce good and quality audits, an important factor is accountability which can affect audit quality. Accuracy and accuracy show that auditors work with full responsibility. Meanwhile, accountability emphasises that audits carried out by auditors are completed properly, on time, checked carefully, evaluated by supervisors, and the results can be accounted for. Auditors work hard and think as much as possible and drain energy in auditing in order to obtain high audit quality.

Hypothesis Development

The Relationship between KAP Rotation and Audit Quality

PMK number 17 of 2008 explains that the KAP engagement limit has been set, namely, for 6 (six) consecutive financial years, this is intended so that the relationship between KAP and the company does not get closer. The limited audit engagement period so that auditor rotation can be used as a solution to achieve a good level of audit quality (Febriyanti & Mertha, 2014). When the company rotates KAP, the company indirectly hopes to get higher quality audit results than the audit results from the previous KAP.

Relationship between Audit Tenure and Audit Quality

Audit tenure is the time span of an auditor's position at KAP who is responsible for conducting client audits. The long-standing relationship between the auditor and the client will make it easier for the auditor to get to know the company's condition so that the auditor is easier to conduct an examination, and report on the independent auditor's report (Ardhityanto, 2020). Audit quality is influenced by audit tenure, the longer the audit tenure, the auditor considers it as income. Long-standing attachments between auditors and clients will foster closeness which can affect auditor independence due to excessive closeness between the two parties and affect audit quality (Effendi & Ulhaq, 2021).

Company Size Relationship with Audit Quality

Firm size is defined as a scale to describe the company size expressed in total assets of the company. The costs associated with agent work within a company typically increase with size. Therefore, large companies often hire high-quality auditors with the intention of achieving superior audit results. Hasanah, Ade Nahdiatul (2018) found that audit quality is influenced by company size. On the other hand, Budiantoro's research (2019) found that audit quality is not affected by company size. After knowing the research gap, the researcher wants to re-examine the impact of company size on the audit quality of manufacturing companies on the IDX.

3. Research Methodology

Data Type and Source

This study applies the use of secondary data derived from sources obtained through observing annual reports on the IDX in manufacturing companies from 2019 to 2021. Based on predetermined criteria, purposive sampling is a technique for selecting samples. The benchmarks are manufacturing companies listed on the IDX from 2019 to 2021, audited manufacturing companies from 2019 to 2021 that have complete financial reports.

Operational Definition of Research Variables

Audit Quality (Y Dependent Variable)

Audit is the evaluation and collection of evidence related to the data required and then reported and determining the level of conformity of the criteria and information obtained (Basworo et al., 2021). According to Aldona & Rina Trisnawati (2018) auditor independence in disclosing violations is very important for the CPA reporting process. Audit quality is the behaviour of the examiner seen based on the output of the examination, where the audit process must be carried out based on the norms at the time of task completion (Nur Affifah & Susilowati, 2021). Factors that have an influence on audit quality in this study are KAP rotation, audit tenure and company size. The audit quality variable is measured by a dummy variable, the company is worth 1 if with the services of 4 large

KAP, worth 0 if with services other than 4 large KAP.

3.2.2 KAP Rotation (Independent Variable X)1

According to Palalangan et al. (2017) audit rotation is a change in KAP when analysing the company's financial statements. However, it cannot be denied that short-term contracts between auditors and companies can cause various problems such as higher levels of engagement fees because contracts are completed quickly and in investigating and tracking client financial statements auditors do not fully understand the client company in question. As a result, mandatory rotation and valourtery of KAP are required in order to minimise special relationships and courage between clients and accounting firms. Audit rotation is needed so that there is no special relationship between KAP and the company. In this variable using a dummy variable proxy, each company is worth 1 for those who hold KAP rotation, otherwise it is worth 0.

3.2.3 Audit Tenure (Independent Variable X)2

Tenure is the length of the audit relationship between the client and KAP in relation to mutually agreed services. Tenure can raise debates when audit tenure is carried out quickly and when it is not carried out quickly (Basworo et al., 2021). Audit tenure is the period of time during which auditors from the same company audit (Nur Affifah & Susilowati, 2021). Auditor independence and audit quality can be affected by the auditor's long-term relationship with his client and the risk of growing closeness (Effendi & Ulhaq, 2021). Measurement in this variable is by adding the number of years of auditor engagement from the same KAP to carry out inspection services, the first year starts with a value of 1 then plus 1 for the next year and so on. This is known from several independent auditor reports to prove how long the auditor period is.

3.2.3 Company Size (Independent Variable X)3

Rahmi et al. (2019) company size is defined as a measure based on the wealth of the company. The terms "company size" and "total assets", "total sales", and "number of employees" are all used to describe the size of a business. Business size increases with value. Business size is also one of several aspects that influence audit quality. The operations of a larger company will be more complicated so that management and ownership are further separated. Internal control

systems can be developed more effectively in large companies because of the availability of more resources and experience than small companies (Effendi & Ulhaq, 2021). This variable proxy uses a ratio scale, namely the natural logarithm:

$$\text{Company Size} = \text{LN (Total Assets)}$$

Analysis Method

The results of data processing will be analysed with the IBM Statistic SPSS 23 for Windows program tool. Data processing is carried out through logistic regression, because the independent variables do not require normality assumptions and the data used are nominal and ratio. In addition, it also measures the fit model (Overall Fit Model), tests the feasibility of the data model which is assessed using the results of the Hosmer and Lameshow's Goodness of Fit test and hypothesis testing which includes the coefficient of determination (Nagelkerke's R Square test) and partial hypothesis testing. The logistic regression analysis model that will be used is:

$$AQ = \alpha + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + e$$

Description:

AQ= Audit Quality

$\beta_1, \beta_2, \beta_3$ = Regression Coefficient

X1 = Effect of KAP Rotation (dummy variable, value 1 if there is a change, value 0 if there is no change)

X2= Audit Tenure (Assignment period in years)

X3= Company size (using total assets) α = Constant e = tolerable error (5%)

4 Results

4.2 Descriptive Statistical Analysis

Table 1. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
KAP Rotation	498	0	1	,16	,371
Tenure Audit	498	1	3	1,74	,798
Company Size	498	22,54	33,54	28,4414	1,63768
Audit Quality	498	0	1	,33	,470
Valid N (listwise)	498				

Descriptive Statistics is used to show a description of the research data. Table 1 shows the total research data of 498 data with a period of 3 years. In the 3-year research period, it is known that the minimum KAP rotation is 0 and the largest is 1. So that a mean value of 0.16 is obtained with a standard deviation of 0.371 on KAP rotation. The minimum engagement period (Tenure Audit)

is 1 year while the maximum engagement period is 3 years. The average audit tenure value shows a value of 1.74 with a standard deviation of 0.798. The company size variable shows the minimum number 22.50 by PT Mulia Industrindo Tbk and the highest number 33.54 by PT Astra International Tbk and obtained a mean of 28.4414 with a standard deviation of 1.63768.

Logistic Regression Test

Data Model Feasibility Test (Hosmer and Lemeshow Test)

Table 2. Hosmer and Lemeshow Test

<i>Step</i>	<i>Chi-square</i>	<i>Df</i>	<i>Sig.</i>
	112,963	8	,113

In assessing the feasibility of the data model, if the significant value is above 0.05, it means that the model can estimate the observation value and is appropriate based on the data that has been studied. In the Hosmer and Lemeshow Test above, the Chi-square number is 12.963 and the significant value shows a value of 0.113. This means that this model is acceptable and suitable for further research.

Table 4. Test Results Assessing the Overall Model (Block number 1: beginning block) Iteration History^{a,b,c,d}

<i>Iteration</i>		<i>-2 Log likelihood</i>	<i>Coefficients</i>			
			<i>Constant</i>	X1	X2	X3
<i>Step 1</i>	1	535,813	-14,669	-,285	-,003	,494
	2	529,577	-18,778	-,403	-,009	,634
	3	529,495	-19,330	-,424	-,010	,653
	4	529,495	-19,339	-,424	-,010	,653
	5	529,495	-19,339	-,424	-,010	,653

In Table 4 after including three independent variables, the -2 Log likelihood column step 1 (Block number 1) shows a value of 529.495. This means that the -2 Log likelihood has decreased from the previous step, which was 631.159. This decrease means that the addition of these three variables can improve the model fit so that the hypothesised model fits the data.

Table 5. Omnibus Tests of Model Coefficients

	<i>Chi-square</i>	<i>Df</i>	<i>Sig.</i>
Step 1 Step101	,	6643	,000
Block101	,	6643	,000
Model101	,	6643	,000

Table 5 compares the -2 Log likelihood value that only includes the constant in table 3, and the -2 Log likelihood that includes the constant and independent variables in table 4. The *chi square* distribution is used in the comparison. With df 3, the *chi square* has a value of 101.664. The significant value of the model, as shown in the previous table, is 0.000. If the significant value is below 5%, then KAP rotation, audit *tenure* and company size simultaneously have an influence on audit quality.

Coefficient of Determination

Table 6. Nagel Kerke R Square Model Summary

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	529,495 ^a	,185	,257

Table 6 shows that 25.7% of the dependent variable can be predicted by all independent variables, and 74.3% is influenced by additional variables that are not tested.

Logistic Regression Analysis

Table 7. Logit Regression Coefficient Test Results

		Variables in the Equation					
		B	S.E.	Wald	df	Sig.	Exp(B)
Step 1 ^a	KAP Rotation	-.424	,323	1,731	1	,188	,654
	Tenure Audit	-.010	,142	,005	1	,943	,990
	Size						
	Company	,653	,076	73,735	1	,000	1,922
	Constant	-19,339	2,208	76,743	1	,000	,000

A negative regression coefficient of -0.424 and a significance level of 0.188 were found when the first hypothesis was tested using logistic regression. As a result, the research findings rejected the initial hypothesis. Meanwhile, the second hypothesis was rejected as the test revealed that audit tenure has no effect on audit quality. Judging from the logistic regression test output, the regression coefficient is negative -0.010 and has a significance level of 0.943 above 0.05. This shows that audit tenure has no effect on audit quality. The third hypothesis test results show that the hypothesis is correct. The regression coefficient is positive 0.653, with a significance level of

0.000 or below 0.05 seen from the test results. This shows that audit quality is significantly influenced by company size.

5. Discussion

The Effect of KAP Rotation on Audit Quality

Based on the findings of this study, audit quality is not significantly affected by KAP rotation. The company's audit quality will not be affected if the KAP has been rotated. The results of hypothesis testing obtained significant results or have a p-value above 0.05, namely 0.188, which indicates that the hypothesis is not accepted. The audit engagement period is not the basis for obtaining high quality audit results, which is the reason for rejecting this hypothesis. The longer the engagement period makes KAP able to understand the condition of the company so that it can be known if there is manipulation of financial statements in the company, but on the other hand there is also trust between KAP and the company which causes the audit procedure strategy used to be undeveloped so that it can risk decreasing audit quality. These results are the same as the findings (Palalangan et al., 2017), (Aldona et al., 2017). (2017), (Aldona & Rina Trisnawati, 2018) and (Berikang et al., 2018) which found that audit quality was not significantly affected by KAP rotation.

The Effect of Audit Tenure on Audit Quality

The second hypothesis is rejected, the significant test result or p-value is above 0.05, namely 0.943, meaning that audit tenure has no effect on audit quality. This finding is identical to previous findings (Ardhityanto, 2020) that audit tenure has no effect on audit quality. Therefore, it is concluded that the obstacles to auditor independence and audit quality stem from the length of the engagement which has the potential for closeness between the auditor and the client. The number of years an auditor has worked on consecutive audit engagements for the same company is used as a measure for this variable.

The Effect of Company Size on Audit Quality

The hypothesis that company size has an effect on audit quality is accepted with significant test results or less than 0.05 p-value, namely 0.000. There are studies that obtain similar results, namely research (Basworo et al., 2021) and (Darya & Puspitasari, 2017) suggesting that audit quality is influenced by company size. This research provides evidence that company size is a value that shows whether the company is large or small. Large companies have a good reputation and have the role of being a broad stakeholder. Large companies will be careful in reporting financial reports where the company must maintain public trust with a quality audit report. In addition, large companies will pay attention to business continuity in the future by providing confidence to investors that the company is able to survive in the following year.

6. Conclusion

The following results were obtained through partial test hypothesis testing:

- a. On the IDX from 2019 to 2021, audit quality in manufacturing companies is not affected by KAP rotation.

- b. Audit tenure has no effect on audit quality in manufacturing companies on the IDX in 2019 and 2021.
- c. Audit quality in manufacturing companies on the IDX in the 2019-2021 range is influenced by company size.

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