

Effect of Audit Quality, Managerial Ownership to Earning Quality in the Banking Company in Indonesia Stock Exchange

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Received: April 29, 2018 Accepted: May 21, 2018 Published: August 23, 2018

doi:10.5296/bmh.v6i2.13075 URL: <http://dx.doi.org/10.5296/bmh.v6i2.13075>

Abstract

This study examines the effect of managerial ownership, the quality of audit on the earning quality in general companies listed in Indonesia Stock Exchange during the periode 2013 to 2016. The sample of this study is companies banking general while companies included in the sample research criteria are as many as 12 companies during 4 years of research so that the total samples are 48 companies.

The results of this study indicate significant results between independent variable and dependent variable showing that managerial ownership does not significantly affect the earning quality, because large ownership of shares by managerial can influence the managerial to perform income smoothing action. Furthermore, quality audit variables significantly influence the earning quality, the amount of audit fee, the auditor maintain integrity to apply a good audit procedure to detect the existence of material misstatement performed by the management so as to increase the quality of corporate profits.

The conclusion of this study indicates that managerial ownership variable has no significant effect to the variable of earning quality, then the audit quality variables with audit fee have a significant effect to earnings quality in banking companies registered in Indonesia Stock Exchange.

Keywords: Earning Quality, Audit Quality, Managerial Ownership

1. Introduction

Company's financial statement is the result of an overview of the company's financial condition made by the management. It is to provide information to outside parties regarding the company's financial condition that contains the company's financial information records, which are in accordance with the purpose of financial statements that is providing information to participant for economic decision making.

There are participants having interest to use financial statement information, namely external and internal parties. External parties are government, banking, shareholders and the general public, while the internal parties are the management and employees.

One of component of financial statements considered important for economic decision making by users of financial statements is Profit. Profit can also be used as one of the parameters to minimize management performance. In addition, profits can also be functioned as a prediction for the stability of investment decisions and lending in the future.

The importance of profit information as one of the parameters to assess the performance of management raises the tendency of management to perform the election procedure of accounting procedures that can support the management. These conditions encourage managers to choose accounting policies that can increase profits in order to perform company performance conditions. Because the assessment of corporate performance is measured based on the profits, then encourage managers to make the tendency of income smoothing action so that earnings will be relatively stable to perform good companies.

Ownership of shares owned by managerial also affects the quality of corporate profits. Jensen and ling (1976) stated that conflicts between managers and shareholder can be balanced if the manager has composition of stock larger companies. So it can be concluded that the higher proportion shares owned by management, it can improve the quality of corporate profits.

The empirical study in Indonesia which examined the effect of audit quality on earnings quality was done by Ward (2009) & Amin (2017). The results of this study indicate that auditor quality audited by specialist auditor is good to increase earnings quality information. It can explain that the more training and skill of auditors' specialist increases, the more quality of profit information generated.

Sty (2009) and Math et al. (2017) also do the same research to test the effect of audit quality to earnings quality. The result of this study is to show that the quality of audit proxy with public accounting office size does not affect the increase of information in earnings quality. So it can be concluded that companies tend to choose to be audited by public accounting office that have low ability in order not to distract the existence of low profit quality and the existence of profit management.

Empirical studies using managerial assistance on earnings quality have been done by Lestari (2017) Ning (2017). The results of these studies refer to the results obtained from managerial to earnings quality. From the results of this study, it can be classified that the higher the managerial level, the more it can improve the quality of financial reporting.

Devi (2008), A.n Triatmoko (2013) conducted similar studies examining the effect of managerial ownership on earnings quality but with different results. The results of the study indicate there is no effect between managerial ownership variable on earnings quality. It can be stated that the proportion of stock owned by management still cannot improve earnings quality because management tends not to provide information that is appropriate to the company's circumstances.

Based on previous research that examines the effect of audit quality, managerial ownership on earnings quality is less consistent. It is necessary to re-examine the effect of the influence of managerial quality of managerial audit on the quality of earnings in banking companies listed in Indonesia Stock Exchange.

2. Theoretical Foundation and Hypotesis Development

2.1 Theoretical Framework

2.1.1 Agency Theory

Jansen and Mg (1976) defines agency theory as a theory that explains the contract between one or more principals and agents, in which the principal provides the authority for decision-making to the agent, where the parties in the agencies have responsibility that must be accepted or executed.

The principal has obligations that must be done, i.e., in terms of supervision, control and answer any matters related to the management of the company to the agent, and provide appropriate and good appreciation for the agent for the good achievement and performance (Yon, 2008, p. 29).

2.1.2 Quality Audit

According, auditor quality is defined as process in assessing financial reporting to find fraudulent actions that are not in accordance with the accounting standards performed by employees reported to the client. DeEnglo (1981) also finds that the quality of audit is influenced by the size of public accounting office.

2.1.3 Managerial Ownership

C.A and Tasik (2017) defined managerial ownership as ownership of shares owned by top management, which has an influence on decision making for each loan amount borrowed, as well as the amount of net profit on own capital. Jansen and Mg (1976) stated that the proportion of share ownership owned by the management and the proportion of shares owned by the institution can be used to troubleshoot problems within the company.

2.1.4 Earning Quality

The earning quality can be explained, as an illustration in which earnings can explain about the economic consequences of transactions. Besides, profits can be said to be qualified, when the reporting is presented openly and honestly. The quality of profit itself cannot be separated from

the benefits of its usefulness that is used as information for users of financial statements D.E, J.J, (2010).

2.2 Hypotesis Development

2.2.1 Audit Quality and Earning Quality

The agency theory explains that there is a contractual relationship in the form of delegation of decision-making authority from the principal (owner) to other agents Jensen and Mg (1976). This relationship can trigger the asymmetry of information that occur within the company, causing agency conflict, which is effective by parties related to the management of the company according by N.M.Y Latrin (2013).

One of the parties that can be supervised and supervised the presence of asymmetric information is auditor. Auditor appointed as supervision must have good audit quality as well as a good audit specialist. From the supervision made by the auditor, it is expected to suppress the existence of asymmetric information, thereby impacting on improving the quality of corporate profits.

Previous research that examined the effect of audit quality with quality of profit has been done by some researchers, i.e., Amin (2017) R wardhani (2009). The results of this study indicate that audit quality variables affect the quality of earnings. While the research that showed the results that are not significant between audit quality variables and earnings quality is done by I.P Rahmawati (2017). Referring to inconsistent institutional and research theory, the hypothesis proposed is as follows:

H1: Audit quality affects earning quality.

2.2.2 Managerial Ownership and Earning Quality

There is a conflict of interest between the principal and the agent in the agency theory, where from the existence of the conflict the agent tends to do actions that benefit the agent. According Lestari (2017) Managerial ownership is the level or proportion of share ownership owned by agents in the company. Since the agent has the same position as the principal, then the way the agent field will be the same as the other principals. So the agent also wants information that is far from practice of data manipulation.

Some research in Indonesia that examines the effect of ownership of shares owned by agents can improve the quality of earnings or significant effect on the quality of profit, i.e. Lestari (2017). The research that examines the effect of managerial ownership that cannot improve the quality of earnings or that has no significant effect on the quality of profits are, H Triatmoko (2013), Devi (2008). Referring to the agency theory and previous research studies that are inconsistent, then the hypothesis proposed is as follows:

H2: Managerial ownership affects the earning quality.

3. Research Method

3.1 Independent Variable

Independent variable in this research is quality earning.

3.1.1 Earning Quality

The earning quality can be determined by referring to “a value that shows how much profit can generate cash money”. Qualified accounting profit can be defined, as earnings that have little perceived noise in it. And can reflect the actual financial performance of the company. In addition, profits have good quality, if the profit becomes a good indicator for future earnings, as well as strongly with future operating cash flows or future operating cash flow. Measurements used to calculate earnings quality are as follows G.S Budi (2005):

$$\text{Quality of Income} = \frac{\text{Operating Cash Flow}}{\text{Earning before tax}}$$

3.2 Dependent Variable

Dependent Variable in this research is Audit Quality, Managerial ownership.

3.2.1 Managerial ownership

Managerial ownership is the percentage of the company's shares owned management E.R.P D.W (2017). The variable percentage of managerial ownership can be calculated by dividing the shares owned by management, directors and commissioners who actively participate in the decision of the company with the number of shares circulated according as below:

$$\text{Managerial Ownership} = \frac{\text{Ownership of managerial share}}{\text{Shares outstanding}} \times 100 \%$$

3.2.2 Audit Quality

Audit quality is the probability that an auditor detects and reports a financial reporting violation management by De Angelo's (1981). According, the purpose of the audit quality of the financial statements is to ensure that financial statements are free from material misstatements, so as not to harm the parties concerned with the company. In this study audit quality is by audit fee, Audit fee is income given by client to auditor as service wage in conducting examination. To measure professional service proxy in financial statement is calculated using natural logarithm.

4. Result

4.1 Descriptive Analysis

Tabel 1. Descriptive analysis

Variable	Minimum	Maximum	Mean	Standard Deviation
Managerial ownership	0,0001	0,1335	0,016473	0,0344682
Audit quality	375.000.000	9.975.000.000	3.285.444.542	2.398.895.041
Earning quality	1,015	9,225	4,051	2,365

Based on table 1, the value of managerial ownership in banking companies listed in the Indonesia Stock Exchange (BEI) in 2013 to 2016 has the lowest value of 0,0001 while the highest value is 0,1335. Then the average managerial ownership in banking companies listed on the Indonesia Stock Exchange (BEI) in 2013 to 2016 amounted to 0,016473 with a deviation of GFA value to the average of 0,0344682.

Further, it is known that the Quality Audit at the banking companies listed on the Indonesia Stock Exchange (BEI) in 2013 to 2016 has the lowest value of 375.000.000, while the highest value amounted to 9.975.000.000. Then the average Audit quality on the listed banking companies in the Indonesia Stock Exchange (BEI) in 2013 to 2016 amounted to 3.285.444.542, with the irregularity of the value of Audit to the average of 2.398.895.041.

Then it is known that Profit Quality in banking companies listed on the Indonesia Stock Exchange (IDX) in 2013 to 2016 has the lowest value of 1,0157, while the highest value amounted to 9,2256. Then average earnings quality on banking companies listed on the Indonesia Stock Exchange (BEI) in 2013 to 2016 amounted to 4,051849 with a deviation of the value of Profitability against average of 2,3652297.

4.2 Goodness of Fit Test

Goodness of fit Model is used to know the magnitude of diversity of exogenous variables in explaining the diversity of endogenous variables, or in other words to know the contribution of exogenous variables to endogenous variables. Goodness of fit Model in Path analysis is done by using the Total Determination Coefficient (R^2). The Goodness of fit Model has been summarized in the following table.

Table 2. Goodness of fit test

Model	R^2
Model 1	0.831

$$R_m^2 = 1 - ((1 - R_2^2) * (1 - R_7^2))$$

$$R_m^2 = 1 - ((1 - 0.712) * (1 - 0.831)) = 0.951$$

R-square model 2 is worth 0.831 or 83.1%. This can show that the diversity of earnings quality can be explained by managerial ownership, audit quality, 83.1%, or in other words managerial ownership contribution, audit quality, IFRS adoption, and Income Smoothing on earnings quality 83.1%, while the rest of 16.9% is another variable contribution not addressed in this study.

The Total Determination Coefficient (R_m^2) is worth 0.951 or 95.1%. This may indicate that the diversity of earnings quality can be explained by the overall model of 95.1%, or in other words the contribution of managerial ownership, the quality of the audit, as a whole to the quality of profit of 95.1%, while the remaining 4.9% is the contribution of other variables that are not discussed in this research.

4.3 Hypothesis Test

Testing of significance is used to test the hypothesis about the presence or absence of the influence of independent variables partially to the dependent variable. The test criteria states that if the probability value < level of significant ($\alpha = \alpha$) then it is stated that the influence of independent variables partially to the dependent variable. Testing of significance can be known through the summary in the following table:

Tabel 3. Testing of significance

Independent	Dependent	Coefficient	Probability
Managerial ownership	Earning quality	-0.111	0.185
Audit quality	Earning quality	0.910	0.000

The effect of managerial ownership on earnings quality yields a probability value of 0.185. The test results show that the probability > α (5%). This means there is no significant direct effect of managerial ownership on earnings quality. Thus hypothesis 4 is not fulfilled. Coefficient value of -0.111 shows that when managerial ownership increases by 1 point, then the quality of profit will decrease by 0.111 points. Assuming other variables is constant. But the decline is not significant.

The effect of audit quality on earnings quality resulted in probability value of 0.000. The test results show that the probability of < α (5%). This means that there is a direct significant effect of audit quality on earnings quality. Thus hypothesis 5 is fulfilled. The coefficient value

of 0.910 indicates that when audit quality rises by 1 point, then the quality of profit will rise by 0.910% assuming other variables are constant.

5. Conclusion

The results in this study found that managerial ownership variable has a negative effect on earning quality. The test result on managerial ownership variable to earning quality in this research shows negative result where the probability value is 0.185, where the probability value is bigger than the 5% value. The result of this research shows that there is no significant influence between managerial ownership variable on earnings quality in banking companies registered in Indonesian Stock Exchange. The result of the test of data in this research strengthens the result of research of Devi and Hasim (2008), and Yustisia (2013) stated that managerial ownership does not significantly affect earning quality.

The results of this study also provide evidence that, the greater the proportion of shares held by management within the company, the more it will provide a gap to the management to perform income smoothing action. So the follow-up income smoothing done by the management within the company will have an impact on the quality of corporate profits.

The results of this study tested the effect of audit quality variables on the earning quality that shows the results of positive or significant influence. So that, it can be interpreted that audit quality variable with proxy fee audit can improve variable of earning quality. Because by receiving high audit fees, auditors will be better in applying proper inspection procedures, so it can detect any material misstatements in corporate financial reporting and can improve the quality of earnings.

The result of examination of audit quality variable having an effect on the quality of profit in this research shows positive result where the probability value 0.000, where the probability value is smaller than the value of 5% alpha. So the results of this study show a significant influence between audit quality variables on the quality of profit in the banking companies listed in Indonesia Stock Exchange. The results of data testing in this research reinforce the results of research by Amen (2017) which state audit quality has a significant effect on earnings quality.

The results of this study indicate the greater the audit fee into proxy quality audit, it can improve the quality of corporate profits. In addition, the quality of auditors' proxied with audit fees can reduce the asymmetric information provided by management to the shareholders. The quality of with audit fee increases the inspection procedure adopted by the public accounting firm, because in order to maintain the reputation and services provided to clients.

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