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THE EFFECTS OF AUDIT QUALITY ON FIRM VALUE OF INDONESIAN FINANCIAL SERVICE SECTOR (FSS)

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ABSTRACT
This paper aims to examine the effect of audit quality, based on the signalling theory, on firm value in the Indonesian financial service sector from 2016 to 2020. This study uses audit firm size (Big Four vs. Non-Big Four) to measure audit quality and Tobin's Q to proxy firm value. Using 60 samples of financial service firms listed on the Indonesia Stock Exchange for 5 years, this study finds that audit quality has a significantly negative effect on firm value in the Indonesian financial service sector. Higher quality audits in this sector cannot be determined by merely using the Big Four or non-Big Four auditors' audit service. This study suggests that companies and regulators view Big Four and Non-Big Four auditors equally based on their performance.

Keywords: *Audit quality; firm value; signalling theory; Big Four auditors; Indonesian financial service sector.*

INTRODUCTION

The financial services sector (FSS) is one of Indonesia's most developed economic sectors. The financial service sector in Indonesia is divided into three categories by the Financial Services Authority (OJK): the banking industry, the capital market, and the non-bank financial industry (NBFI). The Financial Services Authority (OJK) is established on July 16, 2012, to replace Bapepam-LK's duty to ensure that the overall activities within Indonesia's FSS go accordingly to OJK's regulations and Presidential Regulation of Republic Indonesia Number 9, 2009. To date, the banking category dominates the national FSS. Meanwhile, other categories, such as capital market and NBFI, are more or less on equal ground.

More than thirty firms are listed in IDX after 2010, from a total of ninety-four firms in the finance sector alone. This inclination of firm numbers means that competition in this sector almost doubled in size in just a little over a decade. Companies are expected to create and improve their firm's value in response to the rising competition. In contrast, the appreciation of the company's owners, shareholders, and potential investors for corporate financial performance is also shown in its firm value (Wijaya, 2020).

Putu et al. (2014) define firm value as investors' perception of the firm, often associated with stock prices. They also elaborated that stock with high prices makes the firm highly valued and affects the stock market's confidence in its performance. This statement is in harmony with Brigham's (cited by Putu et al., 2014) that if the stock prices are above the book value, it means the market gives the firm more value and considers its excellent prospects. Moreover, the opposite means that the market considers the firm less valuable and contains fewer prospects.

According to Windsor (2017), the firm's value could be manifested in high cash flow, net income, asset worth, or company welfare. All of this information can be found in the firm's balance sheet or financial statement as a tool for the stock market users to assess the firm's value. For future investors to be able to make the right investment decision, they must have valid, accurate, and complete information on the available listed companies in IDX to create that fair firm value assessment. Aobdia et al. (cited by Wijaya, 2020) declared that audit quality helps provide those pieces of information to uninformed future investors on company basis value.

Henceforth, public company' management is responsible for preparing financial statements that are accurate and honest, then being audited annually by external auditors and posted on IDX's online webpage. Regulation No. 29/POJK04/2016 made by OJK, Indonesia's Financial Services Authority, and regulation

No. 306/BEJ/07-2004 made by IDX are obligated to these publicly listed companies to submit audited financial statements. These two regulations contain the obligation to submit interim and annual financial statements to publicly listed companies' capital markets. Also, these regulations' existence caused the demand for high-quality audits and auditors in the audit market.

Rodrigues & Alegria (cited by Wijaya, 2020) explain that the demand for high-quality external audit is because of agency problems caused by differences in shareholders' and company managements' interests. This statement complies with Alsmairat et al.'s (cited by Wijaya, 2020) statement; in developing countries like Indonesia, audit quality is one of the many factors influencing firm value. Also, steadily, the developments of technology and digitalization in developing countries' economic fields are followed by the increasing demand for more relevant, timely, and reliable financial information. This information is critical for financial statement users to make significant decisions on whether to invest in the company or not.

While it has been proven scientifically that the company's management and governance are the primary determiners of its value (Gharaibeh & Qader, 2017; Putu et al., 2014), company managers also have to include external audit quality into consideration. This consideration arises because according to OJK Announcement Number: PENG-3/PM.1/2019, OJK (Otoritas Jasa Keuangan) gave administrative sanctions to one of the Big Four public accounting firms for the PT Hanson International case. Additionally, these administrative sanctions also happened in 2018. According to SP 62/DHMS/OJK/X/2018, another Big Four public accounting firm was given administrative sanctions for the PT Sunprima Nusantara Pembiayaan (SNP) case. These two cases prove that while an external audit is not as vital as its management and governance, an external audit does affect a company's firm value.

Agency Theory

Agency theory is a product of sceptical views over the relationship between the principal and the agent (Jensen & Meckling, 1976). This theory implies that owners and managers will naturally promote the benefits of their wealth rather than the company's (or shareholders') wealth. The agency relationship has been criticized because of the conflict between the principles and the agent's goals.

Jensen and Meckling (1976) explain that limiting the opportunity for agents to harm the principal is possible. The principals can create an agent monitoring mechanism. Aspects of the monitoring mechanism can be strengthened by implementing suitable governance mechanisms inside. Parks and Conlon (cited by Wijaya, 2020) add an argument that monitoring and compensation are critical in the relationship of government agencies. Principals must provide monitoring mechanisms to evaluate the performance of agents adequately. Thus, the entity can determine an appropriate compensation contract and avoid overpaying it. Jensen & Meckling (1976) refer to these conflicts between the principal and the agent as the agency problem. This agency problem, followed by agency cost, will naturally arise with the separation of ownership and control. According to Lonkani (2018), minimizing these agency costs can increase the value of a company.

Pangestuti & Tindangen (2020) divulges in their journal that in the present day, increasing the firm's value is one of the firm's primary goals. Lee et al. (cited by Pangestuti & Tindangen, 2020) state that a company's value is reflected in its stock market's price per share. The higher the market price is, the higher the firm's value. They also state that assessing firm value through the profit approach is doable.

Signalling Theory

According to Spence (Cited by Connelly et al., 2011), the signalling theory is basically about reducing the asymmetry of information between two parties. Spence explained how to use the costly cues of higher education to distinguish low-quality potential employees from high-quality employees in his research. This research has produced a large amount of literature, applying signalling theory to specific environments in various fields, from anthropology to zoology (Bird & Smith, 2005).

Auditing is considered a means of reducing information asymmetry and agency conflicts (Abad et al., 2017). Audit Standard made by IAPI (Ikatan Akuntan Publik Indonesia) affirms that the objective of an audit is to provide reasonable assurance toward financial statements users. Nevertheless, some investigators

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have argued in the agency literature that auditing services are also demanded to reduce costs arising from conflicts of interest between owners and managers (Jensen & Meckling, 1976; Watts & Zimmerman, 1983).

Initially, Titman & Trueman (1986) propose a signalling model that led auditors to provide investors with valuable information to evaluate the value of IPO business.

Eventually, Kirmani & Rao (2000) develop an example to illustrate a basic signalling model that can be used in an auditing context. They differentiate two entities: high-quality companies and low-quality companies. The quality of audit services is defined as the joint probability of market evaluation; that is, the external auditor will (a) discover violations in the client's accounting system and (b) report violations (DeAngelo, 1981). DeAngelo (1981) declares that the likelihood of an auditor discovering a violation depends mainly on the technical ability of the auditor, the audit procedures used in a particular audit, and the extent of sampling. The conditional probability of violations found in the report can be assumed to measure the auditor's independence from the client. Researches by DeAngelo's (1981) and Watts & Zimmerman's (1983) used and confirmed the definition of auditor independence. Furthermore, they believe that the ex-ante value of an audit depends on the auditor's motivation to disclose ex-ante information selectively.

However, there are some differences between perceived audit quality and actual audit quality. The diversification mentioned above between perceived audit quality (based on users' perception of financial statements) and actual audit quality (based on auditor's ability to detect and report accounting errors) is noted by Li Dang in her paper (cited by (Kesimli, 2019). The results of her average annual research of 419 companies showed that there is a positive and significant relationship between earnings management and audit failure, leading her to conclude that the actual low quality of the audit is related to higher levels of earnings management. This conclusion supported the difference between higher and lower quality audits.

Additionally, Eshleman & Guo (2013) has found in their research that the audit quality of the Big Four auditors is higher than that of the non-Big Four auditors. This said quality is proven by the small amount of restatement process on the client company's audited financial statements. This finding is further supported by Aobdia et al. (2015) statement that higher-quality audits by Big Four auditors can produce added value to the capital market in more than one way. The first way, which is quality audits providing a positive signal to uninformed investors, aligns with Kirmani & Rao's (2000) signalling model. Therefore, it is possible to measure high-quality and low-quality public accounting firms based on whether the firms are part of the Big Four public accounting firms or not.

Hypotheses Development

Wijaya (2020) mentions that the link between audit quality and firm value is related to the benefits for the financial information users via a higher audit quality process and the impact on investment decisions' users. This statement is why using the data from the audited financial statements, which are available for every listed company in the Indonesia Stock Exchange, is appropriate. Because based on SPAP (Standar Profesional Akuntan Publik) 200 made by IAI (Ikatan Audit Indonesia), an audit has to reasonably increase the financial statement users' confidence in the information inside the firm's audited financial statements. A study by Reyad (cited by Wijaya, 2020) has proven that financial statements, which higher-quality auditors audit, rarely contain material misstatements. That proven statement implies that the quality of a financial statement audit can affect the number of material misstatements and possibly the firm's value as well.

Therefore, choosing a suitable proxy to measure the audit quality that will affect the firm value is essential. Krishnan (Cited by Wijaya, 2020) found both pieces of evidence that companies audited by the Big Four accounting firms have better financial reporting quality and better earnings quality than non-Big Four accounting firms. Based on the previous statement, there is a higher association between accruals and returns in the firms audited by Big Four public accounting firms. Consequently, it also means that the stock exchange market displays a higher-quality financial information valuation to those financial statements audited by the Big Four (Wijaya, 2020).

It has also been proven in previous research by Aobdia et al. (2015) that a high-quality external audit process can increase the capital market's value in two ways. A high-quality audit can positively signal new uninformed investors and guarantee the firm's financial information accuracy. The proof shows how the

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capital market participants positively react when firms shift from non-Big Four auditors to Big Four auditors (Aobdia et al., 2015).

Besides market valuation, auditor specialist characteristics like particular expertise and knowledge can influence firm value (Wang & Huang, 2014). In a preliminary literature review of research on audit quality, Eshleman & Guo (Cited by Wijaya, 2020) explained that the size of public accounting firms, namely Big Four and non-Big Four, became audit quality's primary indicator. Most of this previous researches are conducted in both Taiwan and the USA. However, Big Four is the four largest professional public accounting service globally; hence, they are responsible for consistently developing and maintaining their international reputation. That also means Big Four auditors must treat all their clients worldwide in an unfluctuating and dependable way (Wijaya, 2020). Based on the above argument, this study proposed the following hypothesis.

H1: Audit quality has a positive effect on firm value in the Indonesian Financial Service Sector

RESEARCH METHOD

The study uses archival data from financial statement reports. The documentation method is done by gathering secondary data from the annual report of each Indonesian financial services sector company through the IDX website or company website.

Method of data analysis

The study uses multiple regression model. The independent variable will be measured using dummy variables, which are coded 1 for Big Four's client or 0 otherwise.

Below is the regression equation used in this study, and the data are processed using SPSS Statistics:

$$TOBINQt = \alpha + \beta 1\ DBIG4t + \beta 2\ LEVt + \beta 3\ LNSIZEt + \beta 4\ PERt + e$$

where TOBINQt = firm value, DBIG4t = dummy Big Four (audit quality), LNSIZEt = log natural total assets, LEVt = leverage, PERt = P/E ratio.

RESULTS AND DISCUSSIONS

Table 1 explains that there are supposed to be 67 sample firms with 335 observational data in this research. The researcher also conducted a data screening test to obtain data with a normal distribution. The overall data screening test results show 33 outliers, so they must be excluded from the analysis. Therefore, 60 financial service firms and 302 observations are chosen as the research samples based on the criteria for obtaining the samples below.

Table 1. Sampling Results

Sample Criteria	**Amount**
Financial service firms listed on the Indonesia Stock Exchange with audited financial statements presented in the Indonesian currency (Rupiah)	105
Financial service firms that have complete audited financial statements for 2016-2020	67
The number of observations during 2016-2020	335
Outliers (data with extreme values)	33
Final Observation Number	302

Descriptive Statistics

Table 2. Descriptive Statistic

	N	Minimum	Maximum	Mean	Std. Deviation
TOBINSQ	302	0,15	1,84	1,0223	0,21110
LEV	302	0,00	0,94	0,7090	0,21922
LNSIZE	302	24,70	34,95	29,8951	2,22454
PER	302	-143,87	2378,00	126,6151	179,89836

Table 3. Descriptive Statistic for Dummy Variable

Dummy Variable	Category	Category Description	Frequency	Percentage (%)
DBIG4	1	Companies audited by the Big Four public accounting firm	147	48,7%
	0	Companies audited by non-Big Four public accounting firm	155	51,3%

As seen in Table 3, the audit quality variable measured by dummy big four has 147 observations for companies audited by the Big Four and 155 observations for companies audited by non-Big Four. Table 4.3 shows that only 48,7% of companies had been audited by one of the Big Four public accounting firms. Thus, it also shows that there are still 51,3% of the Indonesian financial service sector firms that the Big Four public accounting firms have not audited.

This research uses three control variables: leverage, firm size, and profitability. After the necessary data screening and outlier filtering, the leverage variable has a minimum value of 0,00, with a maximum value of 0,94. At the same time, the average value of the leverage is 0,7090, with a standard deviation of 0,21922. The firm size variable has a minimum value of 24,70 with a maximum value of 34,95. Simultaneously, the firm size's average value is 29,8951, with a standard deviation of 2,22454. Lastly, the profitability variable has a minimum value of -143,87 with a maximum value of 2378,00. At the same time, the average value of the profitability is 44,6151, with a standard deviation of 179,89836.

The dependent variable in this research is firm value, which is proxied by Tobin's Q ratio. The descriptive statistical output shows that the firm value variable has a minimum value of 0,15 and a maximum of 1,84. Simultaneously, the average value of the firm value is 1,0223, and the standard deviation is 0,21110.

Hypothesis Testing Results

This research uses a multiple regression model. The test results are as follows.

Table 4. Regression Test Results

Description	Coefficients	t-statistics	Sig.
Constant	0,530	3,118	0,002
DBIG4	-0,134	-5,323	0,000
LNSIZE	0,348	5,921	0,000
LEV	0,010	1,628	0,105
PER	-0,001335	-0,022	0,983
Adjusted R^2	0,187		
f-value	18,314		0,000

Based on the results of the tests, the audit quality variable has a coefficient value of -0,134 and a significance value of 0,000. This condition indicates that firms in the Indonesian financial service sector audited by one of the Big Four public accounting firms have an impact on reducing firm value. These results are not in line with H1, where audit quality positively affects firm value. Therefore, H1 is rejected.

These results are not consistent with prior studies, where audit quality positively affects firm value (Wijaya, 2020; Wang & Huang's 2014). However, the result of this study is consistent with Abid et al.

(2018), Akther & Xu (2020), Bauwhede & Willekens (2004), Louis et al. (2019), Olojede et al. (2020), Park (2017), and Yaşar (2013). According to these prior studies , the reliability of financial statements is not obtainable by merely hiring Big Four auditors. Despite several of OJK's and IFRS's regulations and policies, auditors might not be able to restrain earnings management behavior or another kind of fraud in the company.

At the same time, the Big Four auditors are constantly threatened by credibility and liability crises brought about by more and more lawsuits and criticism of their work (Olojede et al., 2020). Abid et al. (2018) mention in their study that the researches, which have proven that auditors from the Big Four public accounting firms provide higher-quality audits than non-Big Four auditors, are primarily carried out in the United States or Taiwan. Auditors in countries like the United States or Taiwan have higher litigation risk from shareholders if they provide a lower audit quality. This statement is validated by Lennox's (1999) findings, where auditors from Big Four firms are more prone to litigation than others from non-Big Four public accounting firms.

Furthermore, Ajona et al. (cited by Abid et al., 2018) also supported Abid et al.'s claim by stating that Big Four auditors will behave differently in different countries and economic sectors. Their behavior varies because of the differences between each country's economic environment and each sector's regulations. Olojede et al. (2020) point out that changes in its business environment have led to a widening gap in Nigeria's audit expectations. These differences in the economic environment and regulations may also cause an audit expectations gap in the Indonesian financial service sector. According to Park (2017), the Big Four public accounting firms' auditors are expected to detect errors and fraud in the company or take the role of 'watch-dogs.' Meanwhile, auditors' role obligation is to comply with professional rules and regulations in order to provide reasonable assurance (Olojede et al., 2020). This conflict in the auditors' role perception is the one referred to as the audit expectation gap. Furthermore, prior researches have proven that the audit expectation gap caused by litigation and criticism toward auditors affects investors' judgment when evaluating a firm (Akther & Xu, 2020; Olojede et al., 2020; Park, 2017). Therefore, the firm management's effort to signal high firm value by using one of the Big Four auditors' audit services will not be conveyed to investors.

In this research, the investors' expectation is reflected on the firm value variable measured by Tobin's Q, which uses market-based valuation. Therefore, the audit expectation gap from past litigation cases toward a few Big Four auditors might explain why audit quality negatively affects firm value in the Indonesian financial service sector.

CONCLUSIONS

This research is conducted to examine the effects of audit quality on firm value in the Indonesian financial service sector. Based on the results of the tests, it shows that firms in the Indonesian financial service sector audited by one of the Big Four public accounting firms have an impact on reducing firm value.

These results are supported by Abid et al.'s (2018) statement that the reliability of financial statements is not achievable by merely hiring Big Four auditors. Auditors' behavior varies because of the differences between each country's economic environment and each sector's regulations. These differences in the economic environment and regulations may also cause an audit expectations gap in the Indonesian financial service sector.

Consequently, there is also a conflict in the auditors' role perception. This conflict is referred to as the audit expectation gap. In this case, the company's management's attempt to signal a high firm value using one of the Big Four Auditors' audit services will fail to be communicated to investors.

The limitation of this research is that this research cannot be generalized to all types of companies on the Indonesia Stock Exchange or other countries' economic sectors. Further research is expected to study samples from other fast-developing economic sectors on the Indonesia Stock Exchange, for example, the industrial sector or the technology sector.

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