

Effectiveness of Corporate Governance and Audit Quality: The Role of Ownership Concentration as Moderation

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Abstract. *The case of corporate financial statement fraud committed by company management is a phenomenon that often occurs and occurs repeatedly. This condition is exacerbated by the involvement of external auditors to support the fraud. This study aims to determine the effect of corporate governance and audit quality and find out the ownership concentration moderating corporate governance and audit quality. This study uses moderated regression analysis and research samples on manufacturing companies listed on the Indonesia Stock Exchange in 2017-2018. The results of the study stated that corporate governance did not affect audit quality, and the presence of ownership concentration strengthened the effect of the effectiveness of corporate governance on audit quality. The implication of this research is to minimize earnings management practices. The effectiveness of corporate governance expects to run well and regulate the composition of ownership into something fundamental to implement.*

Keywords: *corporate governance, audit quality, ownership concentration*

JEL Classification: G32, G34

Abstrak. *Kasus kecurangan laporan keuangan perusahaan yang dilakukan oleh manajemen perusahaan merupakan satu fenomena yang sering terjadi dan terjadi berulang-ulang. Kondisi ini diperburuk dengan adanya keterlibatan dari auditor eksternal untuk mendukung kecurangan tersebut. Penelitian ini bertujuan untuk mengetahui pengaruh corporate governance dan kualitas audit serta mengetahui adanya konsentrasi kepemilikan memoderasi corporate governance dan kualitas audit. Penelitian ini menggunakan moderated regression analysis dan sampel penelitian pada perusahaan manufaktur yang terdaftar di Bursa Efek Indonesia pada tahun 2017-2018. Hasil penelitian menyatakan bahwa corporate governance tidak berpengaruh terhadap kualitas audit dan adanya konsentrasi kepemilikan memperkuat pengaruh efektivitas corporate governance terhadap kualitas audit. Implikasi dalam penelitian ini adalah guna meminimalisir praktik manajemen laba maka efektivitas corporate governance diharapkan dapat berjalan dengan baik serta mengatur terkait komposisi kepemilikan menjadi sesuatu hal yang sangat penting untuk dilaksanakan.*

Kata Kunci: *corporate governance, kualitas audit, konsentrasi kepemilikan*

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Introduction

The case of corporate financial statement fraud committed by company management is a phenomenon that often occurs and occurs repeatedly. This condition is exacerbated by the involvement of external auditors to support the fraud. There are many cases of financial statement fraud involving the role of external auditors, the latest case in Indonesia which shocked the economic community, especially capital market investors in Indonesia, is the case of PT. Garuda Indonesia Tbk. Management of PT. Garuda Indonesia Tbk with KAP Tanubrata Sutanto Fahmi Bambang & Partners (Member of BDO International) recorded a net profit of USD 809.85 thousand. After an evaluation, it learns that there was collaboration between PT Garuda Indonesia Tbk and PT Mahata Aero Teknologi, wherein this case PT Garuda Indonesia Tbk recorded revenues in the form of receivables of USD 239,940,000. Of this amount, USD 28 million of which is the profit sharing that should pay by PT Mahata Aero Teknologi.

The involvement of auditors to support the practice of fraudulent financial statements by company management reduces the quality of the results of audits conducted by the auditor. Audit quality is a possibility (joint probability) where an auditor will find and report violations that exist in his client's accounting system (DeAngelo, 1981).

A good corporate governance organ is needed to limit the possibility of poor audit quality (AlQadasi & Abidin, 2018). Cadbury (2000) states that corporate governance is a set of regulations governing relations between shareholders, company managers, creditors, the government, and other internal and external stakeholders relating to their rights and obligations, or in other words, a system that directs and controls company. Good corporate governance experts to ensure that there is no misuse of company resources for personal or group interests can provide proper incentives for shareholders and management to achieve goals that are in the interests of the company and shareholders and must facilitate effective monitoring, thereby encouraging companies to use resources more efficiently (Adams et al., 2010).

Corporate governance expects it can minimize agency problems that occur between interested parties in the company (CGPI, 2001). Good corporate governance can minimize information gaps that occur from all stakeholders. Corporate governance emphasizes the principles of transparency, accountability, independence, accountability, and fairness encourages information disclosure for all parties, thereby minimizing the loopholes for company management to commit fraud to increase their prosperity (Ejeagbasi et al., 2015),

However, the implementation of corporate governance conducted by companies is more limited to the fulfillment of government regulations (Bédard et al., 2004). Therefore, effectiveness needed in implementing corporate governance. The effectiveness of corporate governance is a measure of success in meeting or achieving a set of goals related to company success. There are several components to realize the effectiveness of corporate governance, namely board size. Larger board size will be more valuable because of the breadth of member knowledge and its ability to provide more services and resources (Adeyemi & Fagbemi, 2010). Board independence, plays a significant role in increasing the effectiveness of corporate governance (Carcello et al., 2002). Board meetings reflects the effectiveness of the board (Johl et al., 2012). Financial expertise, the presence of board members with financial

expertise, reflects their ability to fulfill their supervisory roles effectively (Wu, 2012), has strong governance (DeFond et al., 2005), and provides adequate financial reports (Aggarwal & Samwick, 2006). Besides, the effectiveness of corporate governance can form from the size of the audit committee; there is a positive relationship between the size of the audit committee and its effectiveness. Size, independence, financial expertise, and frequency impact the audit committee meetings (Kikhia, 2014).

Companies with effective corporate governance motivate management to implement corporate governance principles for the better. The high level of control and supervision arising from the effective management of corporate governance narrows the management of companies to commit fraud on the financial statements they compile. The existence of excellent supervision from directors and commissioners allows individuals in the board not to dare to take individual actions to commit fraud (Al-Thuneibat et al., 2011). Also, large audit committees with a financial capability make it difficult for company management to manipulate financial statements (Abbott & Parker, 2000). This condition is due to effective internal control of the many audit committees that exist and accompany by right financial expertise. Frauds of financial statements are easy to find and control when the audit committee has excellent financial expertise. Besides, high independence in the audit committee makes it possible for the audit committee to work professionally, making it difficult for company management to influence the audit committee to smooth the financial statements they make (Abbott et al., 2003).

The effectiveness of corporate governance that occurs within the company has an impact on improving the quality of financial statements produced by company management (Iqbal et al., 2019). The resulting financial statements are prepared through a series of strict control and supervision processes so that these processes can minimize the irregularities that occur, and the financial statements can be following the real conditions that occur. The lack of irregularities in the financial statements makes it easier for external auditors to conduct audits so that the quality of audits produced by external auditors is of good quality due to the minimal possibility of irregularities committed by the company (Hassan et al., 2014).

Research conducted by AlQadasi & Abidin (2018), and Awadallah (2018) provides empirical evidence that the effectiveness of corporate governance has a positive effect on audit quality. AlQadasi & Abidin (2018) and Awadallah (2018) state that companies with strong governance mechanisms are more likely to demand extensive external audit and pay higher audit fees as a representation of high audit quality. These results indicate that the effectiveness of corporate governance requires external auditors to be able to produce good audit quality in order to provide justice for all stakeholders.

Efforts by company management to implement effective corporate governance to produce good audit quality require support from shareholders. Shareholders, as the owner of the company, are expected to be able to carry out a good supervision process, so that the implementation of effective corporate governance can run well (Demsetz & Villalonga, 2001). Therefore, the form of concentration of corporate ownership contributes to the effective implementation of corporate governance. The concentration of ownership states the distribution of company share ownership (Shleifer & Vishny, 1986). Share ownership concentrate if most shares own by a small number of individuals or groups so that these

shareholders have a relatively dominant number of shares compared to others. Share ownership needs to spread, and if share ownership spreads relatively evenly to the public, no one owns a vast number of shares compared to others (Dallas, 2004).

The distribution of company stock ownership also influences the company's management decisions. The owner, because there are rights, owns this in every company activity. The existence of these rights affects the process of policy decisions in the company. Ownership that concentrates on one individual or group makes it possible for owners to impose their will on the management of the company to improve their welfare so that the resulting policies tend to harm other shareholders. This has an impact on increasing agency conflict between owners from the high ownership gap in companies with concentrated ownership (Henry, 2010).

To realize effective corporate governance accompanied by strict supervision and control mechanisms, this can realize well if ownership concentration can distribute evenly (Gama & Rodrigues, 2013). Evenly distributed ownership allows each owner to have an equal opportunity to determine the policies that apply in the company. Equitable distribution of ownership encourages equal supervision by the owner of the company's management so that the possibility of a coalition of individual owners and shareholders to commit fraud on the financial statements can minimize. Besides, evenly distributed ownership creates strong supervision among fellow owners so that agency conflicts between owners can be resolved (Gama & Rodrigues, 2013).

Research conducted by AlQadasi & Abidin (2018) provides empirical evidence that ownership concentration moderates the effect of corporate governance effectiveness on audit quality. AlQadasi & Abidin (2018) shows that companies with a high concentration of ownership tend to demand lower audit quality than companies with a low concentration of ownership. Then companies with strong governance mechanisms are more likely to demand extensive external audits and higher audit quality. Companies with a low concentration of ownership show that the impact of the effectiveness of corporate governance on audit quality has a more substantial influence than the effect of the effectiveness of corporate governance for companies with a high concentration of ownership. The equation in this study is to look at the influence of internal corporate governance on audit quality, and the role of ownership concentration in increasing the influence of internal corporate governance on audit quality that will produce.

The rise of phenomena related to fraud in the company's financial statements motivates researchers to further study the importance of improving audit quality of each report produced by the company. The absence of a quantitative approach that is certain to measure audit quality encourages researchers to study it in terms of the management of accrual earnings contained in the company's financial statements. Companies with high accrual earnings management in their financial statements indicate as a form of poor audit quality produced by auditors due to earnings deviations from their proper conditions (Becker, DeFond, Jiambalvo, & Subramanyam, 1998). In addition, the dualism of perspective related to the ideal ownership structure in the company in order to improve company performance motivates researchers to study the form of ownership concentration to encourage the creation of the effectiveness of corporate governance. Agency conflict between owners due to the dominance of majority

shareholders over minority shareholders creates a gap in the coercion of the interests of the majority shareholders on company management so that the coalition between them can reduce the quality of financial statements.

Besides, the dualism of perspective related to the ideal ownership structure in the company in order to improve company performance motivates researchers to study the form of ownership concentration to encourage the creation of the effectiveness of corporate governance. Agency conflict between owners due to the dominance of majority shareholders over minority shareholders creates a gap in the coercion of the interests of the majority shareholders on company management so that the coalition between them can reduce the quality of financial statements. Therefore, the researcher seeks to examine how evenly distributed ownership can increase the effectiveness of corporate governance in order to minimize all potential agency conflicts that occur so that the quality of financial statements increases and ends in increasing company performance.

Methods

This research classifies as descriptive quantitative research using a research approach, namely associative research. The population of this research is Indonesian manufacturing companies listed on the Indonesia Stock Exchange (IDX). Furthermore, this study uses a purposive sampling method. Of the 330 companies, there are only 129 companies that meet all the criteria. Data has collected from the company's 2017-2018 annual report.

The effectiveness of corporate governance explains by using eight components namely the size of the board of directors, the independence of the board of directors, board meetings, financial expertise of the board of directors, the size of the audit committee, audit committee independence, audit committee meetings, financial expertise of the audit committee. When the value of each component exceeds the median value, it will indicate that the company's efforts to comply with corporate governance are getting better. This condition will have an impact on management's efforts to carry out corporate governance to be more effective. Furthermore, the effectiveness component of corporate governance will be measured using principal component analysis (PCA) to produce a variable.

Audit quality uses a proxy for earnings management, which using discretionary accruals with the Jones modification approach. Modified Jones's model is a model widely used in various studies related to accounting.

The concentration of ownership illustrates the possibility that each owner has an equal opportunity to determine the policies that apply in the company. This study uses equity, which is a blockholder to measure the capacity of large shareholders and monitor controlling shareholders. Gama & Rodrigues (2013) explained the existence of evenly distributed ownership in a company could see through the difference between ownership that the high difference as measured by the sum of the squares of the difference between the first and second-largest shareholders, and the second and third largest shareholders.

In addition, this study uses the firm size control variable (ln of total assets) and leverage (total debts to total assets). The analysis technique used in this study is moderated regression analysis with the following equation:

Model 1 : Model along with independent variable

$$AQ_{it} = \alpha + \beta_1 GCG_{it} + \beta_2 size_{it} + \beta_3 lev_{it} + \varepsilon_{it} \tag{1}$$

Model 2 : Model along with moderation variable

$$AQ_{it} = \alpha + \beta_1 GCG_{it} + \beta_2 OC_{it} + \beta_3 size_{it} + \beta_4 lev_{it} + \varepsilon_{it} \tag{2}$$

Model 3 : Moderated Regression

$$AQ_{it} = \alpha + \beta_1 GCG_{it} + \beta_2 OC_{it} + \beta_3 GCG*OC_{it} + \beta_4 Size_{it} + \beta_5 lev_{it} + \varepsilon_{it} \tag{3}$$

Result and Discussion

This research uses secondary data, which is data obtained or collected through certain sources. The data in this study obtained through manufacturing companies listed and published on the Indonesia Stock Exchange from 2017-2018. The descriptive statistical results in this study show in Table 1.

Table 1. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
DA	129	0.001241	0.117720	0.041928	0.030874
GCG	129	0.000000	1.000000	0.418487	0.208745
OC	129	-0.855625	-0.000078	-0.298254	0.270979
SIZE	129	25.798610	33.473728	29.088704	1.599521
LEV	129	0.000055	0.648789	0.118804	0.109074
Valid N (listwise)	129				

Source: Data Processing

Based on the results of descriptive statistics in Table 1, it shows that the discretionary accrual (DA) has a minimum value of 0.001241 owned by PT Astra International Tbk in 2018 and a maximum value of 0.117720 owned by PT Indofarma (Persero) Tbk in 2018. The average value of companies owned by all sample companies is 0.041928, with a standard deviation of 0.030874. Corporate Governance (GCG) has a minimum value of 0.000000 owned by PT Charoen Pokphand Indonesia Tbk in 2018 and a maximum value of 1,0000 owned by PT Astra International Tbk in 2018. The average value of companies owned by all sample companies is 0.41848, with a standard deviation of 0.208745. The ownership concentration (OC) has a minimum value of -0.855625 owned by PT HM Sampoerna Tbk in 2018 and a maximum value of 0.000078 owned by PT Kalbe Farma Tbk in 2018. The average value of companies owned by all sample companies is 0.41848, with a standard deviation of 0.208745.

The size of the company has a minimum value of 25.79861 owned by PT Lionmesh Prima Tbk in 2018 and a maximum value of 33.447372 owned by PT Astra International Tbk in 2017. The average value of companies owned by all sample companies is 29.0887, with a standard deviation of 1.59952. Leverage (Lev) has a minimum value of 0.000055 owned by PT Merck Tbk in 2017 and a maximum value of 0.64878 owned by PT Pania Indo Resources Tbk in 2017. The average value of companies owned by all companies until it is equal to 0.11880 with a standard deviation of 0.109074.

Table 2. Normality Test Results

Note	N	Kolmogorov – Smirnov Z	Asymp. Sig. (2-tailed)	Conclusion
Model 1	105	1.140	0.149	Normal
Model 2	105	1.252	0.087	Normal
Model 3	105	1.089	0.186	Normal

Source: Data Processing

Information:

Model 1: Effect of the effectiveness of corporate governance on audit quality

Model 2: Moderation of ownership concentration on the effect of the effectiveness of corporate governance on audit quality

The Kolmogorov-Smirnov test results in Table 2 show that the Kolmogorov-Smirnov value in model 1 is 1,140 and significant at 0.149. The Kolmogorov-Smirnov value in model 2 is 1,252 and significant at 0.087. While the Kolmogorov-Smirnov value in model 3 is 1,089 and significant at 0.186. The results of the three models show that the linear regression model constructed in this study has normally distributed data.

Table 3. Multicollinearity Test Results

Variable	Model 1		Model 2		Model 3	
	TOL	VIF	TOL	VIF	TOL	VIF
GCG	0.989	1.012	0.988	1.013	0.418	2.392
OC	-	-	0.878	1.139	0.143	6.997
OC*GCG	-	-	-	-	0.124	8.053
SIZE	0.864	1.157	0.837	1.194	0.837	1.194
LEV	0.872	1.146	0.768	1.303	0.762	1.313

Source: Data Processing

Table 3 shows that the independent variables used in models 1, 2, and 3 have no symptoms of multicollinearity between the independent variables. This result shows from the VIF value <10 and tolerance value > 0.1, which means there are no symptoms of multicollinearity.

Table 4. Heteroscedasticity Test Results

Variable	Model 1	Model 2	Model 3
GCG	0.326	0.192	0.099
OC	-	0.089	0.572
OC*GCG	-	-	0.219
SIZE	0.419	0.439	0.551
LEV	0.366	0.765	0.604

Source: Data Processing

Table 4 shows that the significant value for all model variables is > 0.05 . Then it can be concluded that all model variables are free from heteroscedasticity or do not experience symptoms of heteroscedasticity.

Table 5. Multiple Linear Regression Test Results

Variabel	Model 1		Model 2		Model 3	
	B	Sig	B	Sig	B	Sig
(Constant)	0.028	0.000	0.239	0.000	0.254	0.000
GCG	0.005	0.741	0.006	0.696	-0.026	0.266
OC	-	-	-0.023	0.076	0.029	0.357
OC*GCG	-	-	-	-	-0.127	0.073
SIZE	-0.007	0.003	-0.007	0.001	-0.007	0.001
LEV	0.050	0.122	0.071	0.038	0.065	0.053

Source: Data Processing

Table 5 shows that corporate governance and leverage has a positive effect on audit quality, and concentrated ownership and size has a negative effect on audit quality. While hypothesis 2 states that the concentration of ownership strengthens the effect of the effectiveness of corporate governance on audit quality. So the second hypothesis is accepted.

Based on the results of the hypothesis testing, the first hypothesis is that corporate governance has a positive effect on audit quality. These results are in line with research conducted by Awadallah (2018). The effectiveness of corporate governance that occurs within the company has an impact on improving the quality of financial statements produced by company management. The resulting financial statements are prepared through a series of strict control and supervision processes so that these processes can minimize the irregularities that occur, and the financial statements can be following the real conditions that occur. The lack of irregularities in the financial statements makes it easier for external auditors to conduct audits so that the quality of audits produced by external auditors is of good quality due to the minimal possibility of irregularities committed by the company.

Based on the results carried out in hypothesis testing, stated that the second hypothesis is the concentration of ownership to strengthen the effect of the effectiveness of corporate governance on audit quality. This result is in line with what was revealed by AlQadasi & Abidin (2018). Efforts to improve the effectiveness of corporate governance require support from shareholders so that the concentration of ownership can contribute to the implementation of effective corporate governance. To realize effective corporate governance accompanied by strict supervision and control mechanisms, this can realize well if ownership concentration can be distributed evenly (Gama & Rodrigues, 2013). Support from distributed ownership evenly for the implementation of sufficient corporate governance forces management to demonstrate its ability to improve the quality of its financial statements so that the financial statements can be accounted well to the owner. This condition has an impact on the strength of support from ownership that is evenly distributed to management to improve the quality of audits produced by external auditors

through the low practice of manipulation by management (Gama & Rodrigues, 2013). The low practice of manipulation by management makes it easy for external auditors to audit evidence due to the absence of data that is hidden by company management.

Conclusion

The results of this study explain that the effectiveness of corporate governance has a positive effect on audit quality. Companies with effective corporate governance will produce financial reports following the conditions that occur and are free from fraud so that it will make it easier for external auditors to conduct audits and produce better audit quality. Besides, the concentration of ownership strengthens the effect of the effectiveness of corporate governance on audit quality. The concentration of ownership evenly distributed can increase the effectiveness of corporate governance. Evenly distributed ownership will encourage companies to improve the quality of their financial statements. This condition can have an impact on improving audit quality because of the low manipulation practices undertaken by management. With the low manipulation, it will make it easy for external auditors to conduct audits of financial statements. This research implies that in order to minimize earnings management practices, the effectiveness of corporate governance expects to run well and regulate the composition of ownership into something fundamental.

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