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OWNERSHIP CONCENTRATION ROLE ON BOARD DIVERSITY AND AUDIT COMMITTEE CHARACTERISTICS ON AUDIT QUALITY

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ABSTRACT

This study aimed to analyze the relationship between board characteristics, audit committee meetings, and audit quality with ownership concentration as the moderating variable. This study used 133 firms in manufacturing sectors as the sample for the period 2016 to 2020. The results of the study show that the board's age diversity has a negative significant effect on audit quality, board's education, and number of audit committee meetings have a significant effect on audit quality. The findings also show that moderating variable could strengthen the relationship between board's age diversity and audit quality and weaken the relationship between the number of audit committee meetings and audit quality.

Keywords: *Audit Quality, Board Diversity, Audit Committee Characteristics, Ownership Concentration*

INTRODUCTION

Financial statements are a tool to examine company performance (Tang & Fiorentina, 2021). Information provided by financial statements can be used in taking results or certainty by the company itself. The performance outcomes provided by the company tend to be used by parties outside the company as a basis of reference for investment.

Financial statements drawn up by a company must be free of any material misrepresentation whether due to error or fraud (Hendi & Sitorus, 2023). To address this, statements must be audited. It is intended to ensure users of the statements that the statements submitted are free of any material misrepresentation and to instill confidence regarding corporate management accountability (Akpotor, Osemwengie & Imuentinyan, 2019).

According to DeAngelo (1981), the quality of an audit refers to an auditor's adeptness in detecting flaws in material representation in the financial statements of the client and in truthfully misrepresentations, reporting material errors, or omissions in the financial statements of the client in the auditor's audit. If an auditor can detect violations and straightforwardly disclose them, the auditor can be considered to have proper audit qualities. This is in line with Saeed, Mustafa & Mohammed (2018), saying that audit quality for users of financial statements is the auditor's guarantee of the audited financial statements, which is free of major violation or misrepresentation.

Public accountants are expected to carry out their tasks professionally to produce quality audits by maintaining independence, having competence, and professional ethics. However, it is widely assumed that audit quality is directly proportional to the reputation bore by the Public Accounting Firm (KAP). This assumption stems from the assumption that audits by large and bona fide firms would be handled more professionally compared to medium and small-scale firms, leading to better output quality (Bernawati & Sukma, 2019).

The researcher designated manufacturing firms as the research objects since firms in this sector are larger in scale compared to other firms. Amidst the COVID-19 pandemic, when the national economy is facing a major transition, manufacturing firms are still able to output good performance on the economy (Anita, A., & Amalia, D. P.2021).

The pandemic has, directly and indirectly, disrupted the economy in Indonesia, and therefore, greater emphasis is put on audit quality to mitigate errors in material representation in financial statements. An auditor must maintain audit quality and be able to obtain adequate and correct audit evidence samples to support the audit opinion to be given. An auditor must be able to collect relevant data in support of the audit opinion and also be able to perform alternative audit procedures (Edi, E., & Wati, E. 2022).. In addition, an auditor must also be more thorough and act professionally towards the tendency for potential major misrepresentation, whether premeditated or not, especially during periods of economic decline (Ngo *et al*., 2020).

Agency theory argues that problems occur in a company due to separation between the owner and managers to minimalize the problems in question. This theory supports the implementation of various management procedures to dominate agent behaviors in jointly owned companies. In a company, individuals or groups own the company in the form of shares and shareholders (Chandra, B., & Cintya, C. 2021). They are the business owners (major shareholders) and to run the business, they delegate power to managers (agents). However, the main problem is the question of whether managers work for themselves or the owners (Panda & Leepsa, 2017).

A study by Musa & Aifuwa (2020) concluded that weighty and accurate quality audit is a service provided to clients and the results of the responsibility of an auditor. Ownership Concentration shows the relatively dominant number of company shares when compared to other company shares owned by a small number of entities/individuals. In other words, dominant/major shareholders tend to command greater control over company activities.

In addition, higher ownership concentration will lead to dominant shareholders sacrificing the interests of minority shareholders, causing the agency problem. Thus, to minimize the agency problem, a company tends to hire the service of BIG4 firms (Darmadi, 2016).

Concentrated shareholders will certainly dedicate more attention to the company's business continuity activities to avoid fraud that can harm them. This surely drives shareholders to enlist the service of a high-quality audit firm to protect their interests as well as provide assurance to the investors regarding company performance (AlQadasi & Abidin, 2018).

LITERATURE REVIEW

Effect of Board's Gender Diversity on Audit Quality

Mustafa, Che-ahmad, and Chandren (2017) found that female directors tend to hire big-four auditors to improve the quality of the financial statements and guard their capital. To reinforce the internal control system, more likely the female directors display a better understanding regarding the difference in the audit quality provided by the big-four auditors and non-big-four auditors.

A study by Mustafa *et al.*, (2018) concluded that the presence of women positively correlates with audit quality, though not significant. This is because female directors are more conservative in the financial reporting process than men. Another study by Akpotor *et al.*, (2019) regarding Diversity of Corporate Boards and Audit Quality showed that the presence of women on the board of directors has a positive and significant correlation with audit quality. Gender diversity within a company can improve boards of directors' efficiency. Indirectly, the presence of women may also improve the audit quality of a company (Kuang, 2011).

A study by Ayobami & Owolabi (2020) demonstrates better audit quality due to an increase in the ratio of women's presence on the board of directors. However, another study did not find any impact of women's presence within boards of directors on audit quality (Musa & Aifuwa, 2020). Another study showed that women's presence correlates positively, but not significantly, with audit quality (Enofe & Igbinoba, 2020). Based on the previous studies, the following hypothesis is formulated:

H_1: Board's gender diversity has a positive significant influence on audit quality.

Effect of Board's Age Diversity on Audit Quality

Mustafa *et al*. (2017) obtained results where the board's age correlates positively and significantly with audit quality. When comparing older directors to younger directors, the former tends to show conservativism, risk-aversion, and has more experience. It goes to show that directors tend to choose external auditors that are most likely to provide quality audit results.

Middle-aged directors are more adept at maximizing shareholder wealth and are more risk-averse (Mustafa, *et al*. 2018). Based on the previous studies, the following hypothesis is formulated:

H_2: Board's age diversity has a positive significant effect on audit quality.

Effect of Board's Education on Audit Quality

Mustafa *et al*. (2017) and Mustafa *et al*. (2018) concluded that education levels of boards of directors have a positive effect on increasing the client's ability to demand high audit quality. Boards of directors with high accounting and finance qualifications can understand financial reporting issues. For that, they seek further confirmation by involving quality auditors. According to Pfeffer & Salancik (1978), education levels of boards of directors can improve their expertise in delivering directions and carrying out company management control. However, according to I. A. Mohammed & Bello (2019), board education should not be used as a benchmark in determining the auditor for the company. Based on the previous studies, the following hypothesis is formulated:

H_3: Board's education levels have a positive significant effect on audit quality.

Effect of Audit Committee Meetings on Audit Quality

According to Regulation No.55/POJK.04/2015 of Financial Services Authority, Audit Committees should conduct regular meetings every three months annually to carry out the monitoring function. The amount of time that can be used by an audit committee to discuss and make decisions is proportional to the number of meetings held (DeFond & Zhang, 2014).

Greater improvement to and transparency of audit quality is linked to routine meetings of audit committees (Khudhair *et al., 2019)*. Sharhan & Bora (2020) dan Velnampy *et al*., (2014) concluded that the frequency of audit committee meetings has a significant positive effect on audit quality. The results of studies by Asiriuwa *et al*., (2018), and Dare *et al*., (2021) demonstrate an insignificant effect of audit committee meetings on audit quality. Based on the previous studies, the following hypothesis is formulated:

H_4: The frequency of audit committee meetings has a positive significant effect on audit quality.

Ownership Concentration in Moderating the Effect of Board Diversity and Audit Committee Characteristics on Audit Quality

A study by Mustafa, *et al*. (2018) used control ownership wedge as a moderating variable in measuring ownership structure, where the measurement was done by looking at the number of shares issued by the company. Another study used ownership concentration as a moderating variable in measuring ownership structure. Ownership concentration is observed from the proportion of the company's share ownership of more than 20% (Desender *et al*., 2013). A study conducted by AlQadasi & Abidin (2018) found that ownership concentration strengthens the relationship between corporate governance and audit quality. With even distribution of share ownership, the company's performance becomes more effective. Based on the previous studies, it is hypothesized that:

H_5: There is a correlation between Board's Gender Diversity and audit quality when moderated by Ownership Concentration

H_6: There is a correlation between Board's Age Diversity and audit quality when moderated by Ownership Concentration

H_7: There is a correlation between Board's Education Levels and audit quality when moderated by Ownership Concentration

H_8: There is a correlation between Frequency of Audit Committee Meetings and audit quality when moderated by Ownership Concentration

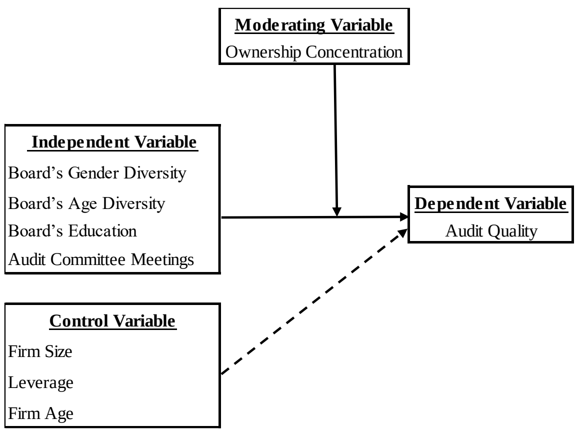

Figure 1. Research Model

METHODS

The company financial statement data, which was secondary, in this study was sourced from Indonesia Stock Exchange. The samples were taken using the purposive sampling technique. The samples were all firms listed on the Indonesia Stock Exchange. The research data criteria included public companies listed on the IDX for the period 2016-2020, operating in the manufacturing sector, and that have published audited financial statements in the relevant year. This study employed a purposive sampling method and there are 133 companies that met the sample criteria. Operationalisation and measurement of variables are as follow:

Table 1. Definitions of variables applied in the research model

Variable	Symbol	Measurement
Dependent Variable		
Audit Quality	AQ	1 if the client is engaged with the service of BIG4 Auditor in a financial year, and 0, otherwise,
Independent Variable		
Board's Gender Diversity	FEMD	Percentage of females on the board
Board's Age Diversity	DAGE	The age of each of the board members to the total number of board members
Board's Education	EDUC	The member of the board with doctoral and master's degrees to the total number of board members.
Audit Committee Meetings	AMEET	Number of meetings held in one year
Moderating Variable		
Ownership Concentration	OWNS	The ratio of the percentage of shares owned by the largest owner in the company and the total number of outstanding shares.
Control Variable		
Firm Size	FSIZE	Natural logarithm of the company's total asset
Leverage	LEV	Total debts over total assets.
Firm Age	FAGE	A number of years since the firm has been in operation.

Source: Data Processed, 2021

RESULT AND DISCUSSION

Until 2020, there were 192 manufacturing firms listed on the Indonesia Stock Exchange until 133 firms met the study criteria. There were 665 observational data and 46 outlier data in this study, resulting in 619 final data. The data were processed using the SPSS program version 25.

Table 2. Descriptive Statistics

Variable	N	Min	Max	Mean	Std. Deviation
FEMD	619	0,0000	0,6667	0,1222	0,1662
DAGE	619	0,0000	0,7813	0,4822	0,1962
EDUC	619	0,0000	1,0000	0,3142	0,2495
AMEET	619	2	24	6,1599	3,8661
OWNS	619	0,1017	0,9964	0,5477	0,2293
FSIZE (Millions Rupiah)	619	88.838	108.370.881	7.872.639	16.463.504
LEV	619	0,0035	2,1830	0,4968	0,2973
FAGE	619	2	90	40,2342	14,5129
FEMD_OWNS	619	0,0000	0,5443	0,0715	0,1095
DAGE_OWNS	619	0,0000	0,6934	0,2570	0,1488
EDUC_OWNS	619	0,0000	0,9040	0,1782	0,1788
AMEET_OWNS	619	0,4069	14,4000	3,3473	2,4313
Valid N (listwise)	619				

Source: Tested data, 2021

Table 3. Dummy Variable Descriptive Statistics

Variable	Category	Frequency	Percentage
AQ	1 = *BIG* 4	230	37,16%
	0 = Non-*BIG* 4	389	62,84%

Source: Tested data, 2021

Table 4. Multicollinearity Test Results

Model	Collinearity Statistics	
	Tolerance	VIF
FEMD	0,1441	6,9405
DAGE	0,2449	4,0831

EDUC	0,1412	7,0830
AMEET	0,1687	5,9275
FEMD_OWNS	0,1252	7,9901
DAGE_OWNS	0,1809	5,5271
EDUC_OWNS	0,1096	9,1220
AMEET_OWNS	0,1232	8,1140
FSIZEL	0,8815	1,1345
LEV	0,9773	1,0232
FAGE	0,9231	1,0834

Source: Tested data, 2021

In Table 4, the tolerance value of the independent, control, and moderating variables is greater than 0.10. The VIF value per variable is also below 10. Therefore, it can be said that the independent variables used are free from multicollinearity symptoms.

Table 5. Hosmer and Lemeshow Test Results

Dependent Variable	df	Sig.	Conclusion
Audit Quality	8	0,4085	Model Fits

Source: Tested data, 2021

The statistical significance value of Hosmer and Lemeshow is 0.4085. If the significance value in the Hosmer and Lemeshow test exceeds 0.05, it can be concluded that this model can be used to estimate a company's audit quality. This shows that the model is acceptable and feasible since the regression model can predict the observation value.

Table 6. Wald Test Results

Var	Unstdz Coeff. B	Wald	Sig.	Result
Constant	-20,5406	82,1444	0,0000	
FEMD	-2,5868	2,2439	0,1341	Insig
DAGE	-2,4337	5,2948	0,0214	Sig -
EDUC	2,1947	4,0902	0,0431	Sig +
AMEET	0,1581	6,4229	0,0113	Sig +
FSIZEL	1,6137	75,1650	0,0000	Sig +
LEV	-2,3965	22,9268	0,0000	Sig -
FAGE	0,0162	5,6971	0,0170	Sig +
FEMD_OWNS	2,1229	0,5970	0,4397	Insig
DAGE_OWNS	4,6142	8,5519	0,0035	Sig +
EDUC_OWNS	-0,7369	0,1879	0,6647	Insig
AMEET_OWNS	-0,3130	7,4165	0,0065	Sig -

Source: Tested data, 2021

As seen in Table 6, it can be concluded that the board's gender diversity has no significant effect on audit quality. This result is in line with a study by Musa & Aifuwa (2020), Mustafa *et al.* (2017), and Enofe & Igbinoba (2020) where there are fewer women that hold a higher position in a company in Indonesia. Only 42.3% of firms have women on their boards. Thus, the presence of women within boards of directors does not affect decisions in selecting auditors. Therefore, it can be concluded that the first hypothesis (H1) which states board's gender diversity has a positive significant influence on audit quality is rejected.

The boards age diversity has a negative significant effect on audit quality. The result shows that 90.6% of Indonesian manufacturing firms between 2016-2020 employed individuals from different generations. The more diverse the age within boards of directors, the lower the probability the BIG4 auditors would be chosen, which is due to the huge age gap leading to differences in perception, standpoint, and thought process. Differing opinions are likely to influence a company to hire auditors outside the BIG4 firms. Therefore, it can be concluded that the second hypothesis (H2) which states boards age diversity has a positive significant effect on audit quality is rejected.

Board's education level has a positive significant effect on audit quality. This result is in line with studies by Mustafa *et al.* (2017) and Mustafa *et al.* (2018). These studies show that 75.6% of companies have board members with master's and doctoral backgrounds. Coupled with an accounting qualification, they tend to choose a more renowned auditor. Directors with higher education levels are more dominant and have the intellectual experience needed in carrying out tasks and making decisions. Therefore, it can be concluded that the third hypothesis (H3) which states Board's education levels have a positive significant effect on audit quality is accepted.

Audit committee meetings has a positive significant effect on audit quality. This argument is in line with studies by Khudhair *et* *al. (*2019*)*, Sharhan & Bora (2020), and Velnampy *et al*. (2014). Based on the Financial Services Authority Regulation No.55/POJK.04/2015, regular audit committee meetings can improve effectiveness in carrying out the monitoring function. Routine audit committee meetings should improve monitoring and control over the representation of corporate financial statements. They also function as a forum to exchange information or opinions about the monitoring results. Therefore, it can be concluded that the fourth hypothesis (H4) which states frequency of audit committee meetings has a positive significant effect on audit quality is accepted.

Board's Gender Diversity has no significant effect on audit quality when moderated by Ownership Concentration. The number of women within boards of directors of manufacturing sector companies in Indonesia for 2016-2020 is insignificant. Thus, ownership concentration has no tangible effect on it. Therefore, it can be concluded that the fifth hypothesis (H5) which states there is a correlation between board's gender diversity and audit quality when moderated by ownership concentration is rejected.

Board's Age Diversity can improve audit quality by enlisting the service of the BIG4 auditors reinforced with support and monitoring of ownership concentration. Concentrated shareholders can usually be individuals or entities. Thus, even when age varies between directors, majority shareholders can play a role to monitor and neutralize any conflict that occurs. Concentrated shareholders also tend to favor the service of the BIG4 auditors to overcome the agency problem and to gain the public's trust in the company. Therefore, it can be concluded that the sixth hypothesis (H6) which states There is a correlation between Board's Age Diversity and audit quality when moderated by Ownership Concentration is accepted.

Board's Education Level has no significant effect on audit quality when moderated by Ownership Concentration. Majority shareholders exert no significant influence in moderating the relationship between the Board's Education Level and audit quality because the role of shareholders is not related to the determination of the board members with a higher education background. Therefore, it can be concluded that the seventh hypothesis (H7) which states there is a correlation between board's education level and audit quality when moderated by ownership concentration is rejected.

The Frequency of Audit Committee Meetings has a significant effect on audit quality when moderated by Ownership Concentration. The beta coefficient was -0.3130 and Sig. value was 0.0065. However, Ownership Concentration turns out to weaken the relation of Frequency of Audit Committee Meetings and Audit Quality. As seen in the descriptive data in Table 4.2, the maximum and minimum values were 14.4000 and 0.4069, respectively, and the mean value was 3.3473. It means that the audit committee meeting is only held three times a year. According to the Financial Services Authority Regulation No.55/POJK.04/2015, audit committee meetings should be held at least four times within a period. It suggests that Ownership Concentration causes this deduction in the number of meetings. This could be because shareholders prioritize potential profits above all. Too many meetings will add to expenses such as travel costs, meeting costs, and time that outweigh the benefits. Therefore, it can be concluded that the eighth hypothesis (H8) which states there is a correlation between frequency of audit committee meetings and audit quality when moderated by ownership concentration is accepted.

Table 7. Nagelkerke R Square Test Results

Dependent Variable	Nagelkerke R Square
Audit Quality	0,3663

Source: Tested data, 2021

It can be concluded that the audit quality accounted for by the independent variable is 36.63%. The other 63.37% are accounted for by other factors outside the research model used.

CONCLUSION

The results of the study show that Board's Gender Diversity has an insignificant effect on audit quality. Furthermore, Board's Education and Audit Committee Meetings have a positive significant effect, and Board's Age Diversity has a negative significant effect on audit quality. Ownership concentration doesn't play a significant role in moderating Board's Gender Diversity and Board's Education. Ownership concentration may strengthen the correlation between Board's Age Diversity and audit quality and diminish the correlation of frequency of audit committee meetings and audit quality. The study has some limitations especially in terms of data which only attempt to observe all Indonesian manufacturing companies listed in the Indonesian Stock Exchange, and only managed to collect 133 companies for five years. For future studies, would be better to include additional variables, such as audit tenure, audit fee, and/or auditor expertise.

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