

Conference Paper

The Influence of Audit Quality and Board Size on Company Value

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Abstract

The purpose of the study is to analyze the influence of board size and audit quality on company value listed on the LQ 45 index of the Indonesian Stock Exchange for the 2012–2014 period. The variables that were tested in this study consist of board size and audit quality, which were measured using indicators of auditor competence and auditor independence, and by using leverage and company value as the control variables. This study used a data panel regression technique and a random effect method (REM) for processing the data. This method was chosen because the Hausman test probability value is more than 5 percent (not significant). The results of the study were: (1) board size positively influences company value, and (2) audit quality positively influences company value when measured using auditor competence, and negatively influences company value when measured using auditor independence.

Keywords: company value, board size, auditor competence, auditor independence

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Received: 25 February 2018

Accepted: 26 May 2018

Published: 26 June 2018

Publishing services provided by
Knowledge E

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Selection and Peer-review under the responsibility of the ICIFEB Conference Committee.

1. Introduction

Brigham and Houston (2010) state that the main purpose of financial management is to maximize the stockholder assets in the long term. To become more reliable for the investors to encourage them to invest their money in the company, good-quality audit services need to be used, such as auditors from the Big Four Public Accountant Firms (Kantor Akuntan Publik (KAPs)). According to Christiawan (2003), the quality of audit services is determined based on two things, which are independence and competence. Independence is an ethic that must be kept by the auditor, who is required to be honest and objective in auditing. There is no independence if an auditor has a relationship (family or financial) with the client [15]. Auditor independence is shown through audit opinion, which is one of the information sources that is useful in making decisions for investing and budgeting (Guillamon, 2003).

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Auditor competence can be determined using the size of KAP [13]. Based on signaling theory (Watts and Zimmerman, 1981), a company will be motivated to give information regarding the achievements and failures of the company. Audit quality can be a piece of information that gives positive and negative signals. Nonetheless, the research results of Rosner (2003) and Juliardi (2013) show that audit quality does not have a significant influence on company value for both those audited by the Big Four KAPs as well as non-Big Four firms. The research conducted by Juliardi (2013) uses the stock market price to measure company value. Another phenomenon identified by Afiah (2015) reveals that the quality of many local KAPs do not meet the international competence standards; this is because the accountancy-service market is dominated by the Big Four, so the majority of local KAPs are not capable of providing programs to increase their accountancy quality. For this reason, it needs to be tested whether the audit quality influences the company value.

Isshaq et al. (2009) and Sari and Usman (2014) explain that board size has a significant positive influence on company value. Furthermore, Wulandari (2006) and Sari and Ardiana (2014) show that the positive relationship is not significant. On the other hand, Gill and Mathur (2011) observe that board size has a negative influence on company value.

Based on the aforementioned information, the purposes of this study are (1) to analyze the influence of audit quality on company value and (2) to analyze the influence of board size on company value.

2. Literature Review

2.1. Audit quality

DeAngelo (1981) defines audit quality as the assessment by the market with respect to the possibility that the auditor will present (a) a finding regarding a violation in the client's accountancy system and (b) a violation in the entry. Christiawan (2002) shows that the audit quality can be determined using two things, which are independence and competence. To produce a good-quality audit, an auditor is required to have adequate competence and good independence. Auditor competence is identified by the size of the KAN, which in this case is the Big Four.

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2.2. Board size

Board size is the total number of people on the board of directors and board of commissioners in the company. The board of commissioners is the part of the company that has a duty to provide general supervision and/or specific supervision based on the articles of association and give advice to the board of directors. The board of directors is the part of the company that has the authority and full responsibility for the management of the company based on the aims and purposes of the company, and acts as the company representative, both inside and outside the courts according to the rules of the article of association [22].

In general, the boards of the company will make decisions on company policy/strategy and make sure that the company has fulfilled all the rules detailed in the article of association and the valid laws. Agency theory states that a bigger board size will make the management supervision more effective, have the potential to provide wider experience and knowledge, give better advice for company advancement and produce higher company performance (Jensen and Meckling, 1976).

2.3. Leverage

The composition of the company's capital structure (i.e., the composition of debt and equity) could affect the company value. Discussions around this topic began with a study by Modigliani and Miller (1958), and, since that time, various models related to capital structure have appeared. According to Booth et al. (2001), there are three kinds of main theoretical model explaining capital structure/sources of financing, such as (1) the static trade-off model (STO), (2) the pecking order hypothesis (POH) and (3) the agency theory framework (ATF). In each model, the option between debt and equity

depends on specific factors for the company as well as its institutional factors. Booth et al. (2001) observe that those factors are the consequences of tax, agency costs, financial distress, funding hierarchy and the POH.

2.4. Company size

Companies are categorized into two sizes: small-scale and big-scale companies. The research conducted by Gill and Obradovich (2012) states that company size has a positive effect and is significant to the company value. The result of that research supports the research conducted by Yunita (2011), which explains that big companies have more resources to increase company value because they have better access to external information than small companies.

2.5. Company value

The purpose of establishing a company is to increase company value or to grow the company. The growth of a company that can easily be seen is the end result of an external assessment of company assets as well as growth in the stock market. Company value is the price that would be paid if the company were going to be sold. Company value can be reflected through stock price. The higher the stock price, the higher the rate of return to the investor, which means that the company value gets higher as it is in accordance with the objectives of the company, which is to maximize the prosperity of the shareholders.

This study investigates company value using the Tobin's Q ratio. The Tobin's Q ratio was chosen because it is more rational to measure company value using the Tobin's Q ratio considering that the elements of obligation need to be counted as the basis of the calculation. One of the modified and simplified versions of Tobin's Q, by Smithers and Wright (2007), is as follows:

$$Q = (EMV + D)/(EBV + D),$$

where:

EMV = Equity market value

EBV = Equity book value

D = Debt

2.6. Framework and hypotheses

The quality of the audit being measured with respect to the auditor's independence shows that the higher the independence level of the auditor, the more enhanced the credibility of the financial report. It is expected that this, along with the enhanced credibility of the financial report, will affect the company stock price, and increase the company value. Ardiana (2014) conducted a research project that proves that the independence of an auditor has a significant positive effect; it states that the higher the auditor's independence, the more it will enhance the credibility of the financial report, and it is expected to increase the company value. A different result is given by Dewata et al. (2015), who believe that an auditor's independence does not have significant effect on the company value.

Agency theory claims that a bigger board size will help to make management control more effective, has the potential to provide broader experience and knowledge, gives better suggestions toward company progress and results in higher company performance. The theory is supported by research conducted by Issha et al. (2009) and Sari and Usman (2004), who maintain that board size has a significant positive effect on company value. However, research conducted by Wulandari (2006) and Sari and Ardiana (2014) concludes that board size might have a positive relationship, but it does not significantly affect the company value. These research projects are supported by Dewata et al. (2015), who state that board size has a positive effect on the company value. However, a research project conducted by Gill and Marthur (2011) produced a different result, which is that board size has a significant negative effect on the company value.

The hypotheses tested in this research are:

H₁: Board size has a positive effect on company value.

H_{2a}: The competence of the auditor has a positive effect on company value.

H_{2b}: The independence of the auditor has a positive effect on company value.

3. Research Methodology

3.1. Sample and population

The population of this research is the annual financial reports of companies who are listed on the Indonesian Stock Exchange (IDX). The data was taken from the Indonesian

Capital Market Directory (ICMD) and the IDX website (n.d.). The companies are those listed in index LQ 45 from 2012–2014.

3.2. Operational variables

1. Board size, which is the combined total number of personnel in the board of commissioners and board of directors of a company.
2. Audit competence quality, implemented using a dummy variable of 1 for a company that is audited by a Big Four KAP and 0 for a company that is audited by a non-Big-Four KAP.
3. A proxy of independence with audit opinion for company I in year t , such as:
 4. Unqualified opinion = score of 4
 5. Modified unqualified opinion = score of 3
 6. Qualified opinion = score of 2
 7. Adverse opinion = score of 1
 8. Disclaimer of opinion = score of 0
9. Company account, which is the Tobin's Q ratio
10. Leverage debt/asset

4. Result and Discussion

4.1. Regression model analysis

The data panel regression technique can implement three alternative approaches that are the common-constant method (i.e., the pooled ordinary least squares [OLS] method), the fixed effect method (FEM) and the random effect method (REM). The result of implementing the common-constant method shows that this model contains an auto-correlation with the Durbin-Watson value of 0.2819, which is less than 2. In conclusion, the common-constant method is too simple to describe the phenomenon. Testing of this model can be explored further by using the Hausman test.

The Hausman test is done to compare the FEM and REM. The result of this test will allow the researcher to choose the best research model from FEM and REM. The probability value of a cross-section random test is 0.6807, which means there is no

significance with a significance level 95 percent ($\alpha = 5\%$). Therefore, the decision for the Hausman test is to accept (p -value > 0.05), which resulted in the following:

H_0 : REM

H_1 : FEM

Hence, the method chosen for this research was REM.

The result of the classic assumption test shows that the data is normal, there is no multi-collinearity in the regression model, there is no heteroscedasticity and there is no auto-correlation.

4.2. Significance test (T test and F test)

The result of the output from the Eviews 9 computer program was the following double regression equation:

$$Q = 17.1336 + 0.0732BS + 0.4980KA - 0.1374IA + 0.4386FS - 0.4155LEV.$$

The result of the F test was a probability of 0.000022, which shows a significant influence based on a significance (α) of less than 5 percent. It means that the loose and controlled variables, which consist of board size, audit quality, leverage and company size, affect the company account that is listed in LQ 45.

The result of the T test is a positive constant, which shows that if the board size, audit quality, leverage and company size are in fixed conditions, the company account increases by 17.1336. The regression coefficient for board size (BS) had a positive value and every additional member of personnel (commissioners and directors) will increase the company account by 0.0732. The regression coefficient for the leverage variable had a negative value, which means that if the company increases stock through leverage (LEV), it could decrease the company account by 0.4155.

Audit quality (KA), which is measured using an auditor competence indicator, has a positive regressive coefficient; this means that if a company uses a Big Four KAP, the company account will increase by 0.4980. However, from the auditor independence (IA) indicator used to measure negative audit quality, it means that every audit opinion by an auditor could decrease the company account by 0.1374.

4.3. Determination coefficient testing (R^2)

Determination coefficient testing is used to measure the size of the impact of the model's ability to explain the variable. The determination coefficient produced by this research was 31.68 percent, which means the variables investigated in this research explain 31.68 percent of the impact and the rest (68.32%) is explained by variables outside of the model.

4.4. Discussion

Board size has a positive influence on the value of the company. This means that the greater the number of people on the board of commissioners and board of directors, the better the value of the company in the eyes of investors. This supports the descriptive results that demonstrate the average company board size is 10.13; this amount is considered to fulfill the rules of the Financial Services Authority (Otoritas Jasa Keuangan (OJK)), which state that the number of board members (commissioners and directors) should be a maximum of six persons to actualize good governance of the company, and that could raise the company value. This result supports the agency theory that explains that a bigger board size makes monitoring management more effective. The implication of the results of this survey is that the bigger the board size (which includes of directors, dependent commissioners and independent commissioners), the higher the company value; this led to the conclusion that adding one more member to a board could increase the amount of monitoring and the effectiveness of making decisions. When the decisions are considered to have a certain level of quality and be efficient, it could attract investors and would increase the company value. The results of this survey are supported by the studies of Isshaq et al. (2009), Dewata et al. (2015) and John et al. (2015), which maintain that the board size has a positive influence on the company value.

The variable of audit quality, which is proxied by the auditor's competence and auditor's independence, shows a different influence on the company value at a different significance level. An auditor's competence might have a positive influence on the company value at a 5 percent significance level, while an auditor's independence might have a negative influence on the company value at a 10 percent significance level. For the sample in this survey, the auditor's competence has a positive influence on the company value, which happens because the majority of the companies listed on LQ 45 (92.59%) use the services of one of the Big Four KAPs to audit their financial

reports. This can be interpreted to mean that, for investors, the results of an audit that is completed by one of the Big Four KAPs is sufficiently trusted that it could increase the company value. Investors of companies on LQ 45 believe that having one of the Big Four KAPs produce their audit report would maintain their credibility, and that the auditors of the Big Four KAPs would be more careful when completing an audit to detect any fraud perpetrated by its clients. An audit report that has good credibility will have an influence on the stock price of the company, so that could increase the company value. This result supports Hussainey's (2009) and Ardiana's (2014) studies.

Another proxy of the audit quality is auditor independence, which has a negative influence on the company value. This is because the market responds negatively to the stock price of the company where there is a common opinion on an audit without any exceptions. In theory, a common opinion without exceptions is what is most expected by the clients because such a common opinion could guarantee that the financial report that was arranged by the management of the company does not contain any false material and reaches the standards for an appropriate financial accountant. This survey does not support Ardiana's (2014) study, which finds that auditor independence has a positive influence on the values of the company.

The result of the hypothesis test for leverage as a control variable shows that it has no significant effect on the company value. This survey demonstrates that companies that are listed on LQ 45 mostly use a source of finances from within the company instead of borrowing finances, so that the approximate amount of debt that the company owes will not affect the approximate company value. This survey supports Putri et al.'s (2015) survey. Another reason is that investors do not pay attention to the approximate debts that the company owes because the investors are more interested in how the management of the company utilizes the financial debt itself effectively and efficiently to achieve more value for the company. This survey also supports the survey of Mahendra Dj et al. (2012).

Firm size as a control variable under the influence of board size and audit quality on the company value is found to have a positive significant influence on the company values for the companies that are listed on LQ 45. This translates as the fact that a bigger level of assets can allow the repayment of an investment, which will lessen the level of uncertainty of the investors. The results of this survey support the findings of Sofyaningsih and Hardiningsih (2011), Gill and Obradovich (2012) and Le and Phung (2013), which reveal that the size of the company has a significant and positive influence on the company value because a big company is considered to have more assets and be more stable as a result of the projection of a high stock price that keeps rising.

5. Conclusion and Implications

5.1. Conclusion

The results of this survey are as follows:

1. Board size has a positive influence on the company value. This means that the greater the number of members of the board of commissioners and board of directors, the better the company value in the eyes of the investors.
2. The auditor competence proxy of the audit quality variable has a positive influence on the company value. This means that, for investors, the audit reports that are produced by the Big Four KAPs are trusted, which could increase the company value. Investors of companies on LQ 45 think that the Big Four KAPs would wish to maintain their credibility in producing their audit reports, so auditors of the Big Four KAPs will be careful in completing the audit process to detect any fraud perpetrated by the clients.
3. The auditor independence proxy of the audit quality variable has a negative influence on the company value. This is because the market responds negatively to the stock price of the company for which there is a common opinion on an audit without exceptions.

5.2. Implications

The results of this survey are expected to provide suggestions to the investors who are assessing a company for the purpose of making an investment. For investors, the combined size of the boards of commissioners and directors is consideration for undertaking an investment. This is because the bigger the size of the company's board, the better the company value. That means that a company is free from the management practice of profit and has a good governance. In addition, the audit quality is also a consideration when making a decision to invest in a company. If that company is audited by one of the Big Four KAPs, it can be concluded that the financial information that they present in a report is reliable.

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