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THE INFLUENCE OF AUDIT ROTATION, AUDIT TENURE, AND WORKLOAD ON AUDIT QUALITY AT CONSUMER GOODS SECTOR LISTED IN INDONESIA STOCK EXCHANGE

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ABSTRACT

This research aims to study the influence of audit rotation, audit tenure, and workload on audit quality. The population of this research is all consumer goods sector listed on Indonesia Stock Exchange from 2012 to 2016. Sampling is done by using a purposive sampling method and it obtained 26 companies as the sample this research. This research uses a regression panel method that shows how the audit rotation, audit tenure, and workload can explain and affect 42,63% of audit quality, while 57,37% of audit quality is caused by other factors outside of the model. Based on the results, it can be concluded that audit rotation and audit tenure has a positive and significant impact on audit quality, that is, audit rotation can improve audit quality, and the longer audit tenure, the better the audit quality will be. Workload has a negative and insignificant relationship to audit quality, meaning that the higher the workload pressure, the lower the audit quality will be.

KEY WORDS

Audit quality, audit rotation, audit tenure, workload.

The consumer goods sector is one of the interesting sectors to invest. This sector refers to a company that provides goods widely used by consumers or the public and is a sector supporting economic growth because it is growing quite rapidly even during the monetary crisis making it a saviour for the economy of the country (Kontan.co.id, 2016). Decision making to maximize investment values by investors can be generated by reading financial statements.

A financial statement is an important means of assessing the financial position of a company (Hartono and Wahyuni, 2016). It is useful in making investment decisions, which in turn can maximize the value of investments from investors. To ensure that financial statement is presented fairly, an independent auditor is required. Sussanto et al. (2012) state an auditor plays an important role in bridging the interests of investors as users of financial statements and companies as providers of financial statements.

One of the cases at Toshiba in 2015 is one example of companies that manipulate financial statements, which involves auditors in the fraud, causing the financial statement not qualified. The public accounting firm which audits the financial statement of Toshiba was Ernst & Young (EY). EY that had been working to audit Toshiba for 12 years from 2002 to 2014 was unable to find and report the fraud. Because of that fraud, Japan's financial regulator fined Ernst & Young for 2.1 billion yen (\$ 17.4 million) after the agency failed to see the deviation of accounting standards at Toshiba and suspended Ernst & Young from taking a new business contract for three months (Kompas.com, 2016 in Tresnawaty and Kurniasyah, 2018).

The Toshiba case above shows that the length of Ernst & Young's audit seems to decrease the audit quality. For 12 consecutive years, Toshiba has never rotated the public accounting firm it hires, resulting in a close relationship between the public accounting firm and its client. The phenomenon illustrates the many not qualified financial statements. Although a company is using the services of an external auditor, but the auditor is not able to disclose the financial statements properly that leads to decreased audit quality. The bankruptcy of Enron and major corporations in the United States, which triggered by

manipulation of bookkeeping, became the turning point for the emergence of stricter regulations on public accounting firms (Irianto et al., 2014).

This study uses three independent variables of audit rotation, audit tenure, and workload and one dependent variable of audit quality. The research sample is in the manufacturing company of the consumer goods sector listed on the Indonesia Stock Exchange from 2012 to 2016; this is different from the previous studies, such as the study by Hansen et al. (2007), where the sample used was KAP Arthur Andersen and KAP BIG4 from 1999 to 2003, and by Siregar, Fitriany, Wibowo and Anggraita (2011), that used samples of all companies listed on the Indonesia Stock Exchange from 1999 to 2008.

Ishak, Perdanna, and Widjayanto (2015) state the influence of audit rotation on audit quality both bring positive and negative arguments. Audit rotation aims to increase audit quality, with assumption that the longer the relationship between auditor and client, the lower the independency of auditor will be. O (2015) states the audit rotation consists of rotation of a public accounting firm and auditor. Carey and Simnett (2006) research shows a significant negative effect between audit rotation and audit quality.

Audit rotation can affect audit quality (Isaac, Perdanna and Widjayanto, 2015). The effect of audit rotation on audit quality provides some positive and negative arguments. The former auditor cannot provide an understanding of the client to the new auditor, so before the audit engagement, the new auditor takes time to understand the client's condition that auditor rotation does not affect audit quality. Firth et al. (2012) have found that audit rotation regulations are associated with an increased likelihood of modified audit opinion in terms of audit quality. In realizing the users' trust in the financial statement, the company seeks to improve the quality of audited financial statements. Some developed countries like in the EU have implemented mandatory rotation on audit firms; this is also the case with developing countries like Indonesia and Malaysia.

The auditor's rotation aims to improve the quality of the audit, assuming that the longer the relationship between the auditor (the audit partner) and the public accounting firm with the client, the lower the auditor's independence will be. O (2015) states audit rotation consists of rotation of public accounting firm and rotation of auditors. Carey and Simnett (2006) have reported a significant negative relationship between audit rotation regulation and audit quality.

The length of the engagement between the auditor and the public accounting firm with the client is called audit tenure. Supposedly, the engagement between the auditor and the client will help to result in the optimal audit quality. However, such short audit tenure will not help the auditor to understand the client specifically. However, the long audit tenure can also affect auditor's independence and objectivity due to the familiarity between the auditor and the company management.

The negative relationship between audit rotation and audit tenure is supported by research conducted by Davis et al. (2002), Siregar et al. (2011), Isaac (2015), and Fitriany (2015) that audit tenure and audit rotation has a negative impact on audit quality; Cameran et al. (2008) and Isaac (2015) confirm the same opinio that audit rotation has a negative effect on audit quality, as more frequent rotations will result in lower audit quality.

An auditor has a responsibility to pay attention not only to the number of clients, but also to the limited time to complete the audit process. Decree of BAPEPAM No.36/PM/2003 has stipulated the obligation of each issuer to submit audited financial statements at the end of the third month (90 days) at the latest after the date of the financial statement is issued; this time will be the peak season for auditors. According to Lopez and Peters (2012), workload is refers to the busiest time that occurs at the beginning of the year because most companies have a fiscal year ending in December. Adityasih (2010) has argued that the number of clients (audit capacity) handled by the auditor will affect the quality of the resulting audit. The large number of clients raises a high workload for the auditor and may degrade the auditor's ability to discover material faults and report violations in the client's accounting system.

Based on the above descriptions and previous research, this research aims to analyze the influence of auditor rotation on audit quality, the influence of audit tenure on audit quality and the influence of workload on audit quality on consumer goods sectors listed on Indonesia Stock Exchange from 2012 to 2016.

LITERATURE REVIEW

The agency theory developed by Jensen and Meckling (1976) explains the conflict of interest between management as the agent and the owner as the principal. Colifa and Suryono (2015) state the agency theory explains the conflict between managers as agents with agency relationships, when a contract exists between the principal and the manager (agent). In the contract, manager is bound to provide services to owners/principals. Principals want to know all information including management activities related to investment or funds in the company. This is performed by requesting an accountability report on the agent (management). Based on these reports, the principal can assess management performance.

Fitriany (2015) states the motivation of self-interest, which in reality manager does not always act as what the owner desires; one of the causes is moral hazard (the manager's desire to act for personal gain). On the other hand, there is an agency problem from the auditor side in which the auditor has an interest in maintaining and improving the audit service revenue by satisfying the client's wishes, especially long-term clients. This is performed in order to ensure the continuity of the audit engagement so that the auditor's earnings are guaranteed. The incentives to work with management come from the economic dependence. Thus, in the economic interest, a long-term audit engagement will lead to closeness and loyalty between the auditor and the client. This reduces the audit objectivity and decreases the auditor's independence and is influencing audit quality.

Resilience was first formulated by Block under the name of ego-resilience, which is defined as a general ability that involves high and flexible self-adjustment when faced with internal or external pressure (Klohen, 1996). Xianon and Zhang (2007) affirm that resilience is used to express individual capabilities to survive and be able to adapt in a state of stress and suffering. The theory of resilience for individuals is defined as the human capacity to deal with, overcome and even change due to traumatic experiences (Schoon, 2006).

Auditors are required not only to work professionally, but also to complete the task timely. Quality reports demanded in such limited time have been a pressure for the auditor. Dhermawan and Rasuli (2018) explain that pressure is a challenge that must be faced by an auditor in the form of workload. Hansen et al. (2007) state workload is also known as an audit capacity stress, referring to the pressure faced by the auditor in terms of the number of clients.

Audit quality according to Arens et al. (2010) is how well the audit detects and reports misstatements in the financial statements. De Angelo (1981) has defined audit quality as the possibility that an auditor will find and report an infringement that exists within a client's accounting system.

Mgbame et al. (2012) have concluded that the higher the quality of financial statements produced and perceived, the more credible the financial statements will be thereby increasing the user's confidence in financial statements. Company management also tries to serve the best for the company by choosing an auditor that can reflect the image of a good manager in the viewpoint of investors. Thus, hopefully the investors will invest in the company and will make a good image for the principal, and this also supported by the good audit quality. Audit quality is the negative value of the discretionary accrual value. Discretionary accruals measured using the Kaznik (1999) model is illustrated as follows:

$$DACC_{it} = TACC_{it} - NDACC_{it}$$

Where: $TACC_{it}$ = total accruals of I Company in t period; $NDACC_{it}$ = non-discretionary accruals.

Irianto (2014) argues that the bankruptcy of Enron and major corporations in the United States have been caused by manipulation of bookkeeping. This became the turning point for the emergence of more stringent regulations on public accounting firms. One of the phenomenal regulations is the Sarbanes-Oxley Act, which regulates audit rotation.

The Sarbanes-Oxley Act is based on the consideration that the auditor and the audited client may build such too close relationship if they have been in partnership for very long time, and such this relationship may negatively impact independence, reliability, and quality of the audit; this kind of relationship has contributed to the financial scandals in the United States (Irianto et al., 2014). Audit rotation also has good benefit such as to prevent and increase auditor independency, audit quality, sharing knowledge and profit, and to prevent collusion between the auditor and client. Good audit quality reflects a good financial report.

Siregar et al. (2011) have analyzed the effect of audit rotation and audit tenure on audit quality and show that auditor rotation will reduce audit quality. The research results indicate that there need rules to overcome the negative effect of long audit assignment period, but the current audit rotation rules do not seem to be very effective. Fitriany (2015) proves that in the period before regulation, the period of auditing has no influence on the audit quality. However, after the regulation is established, the first period of audit has a convex relationship with audit quality from a neutral point of view to timeliness. This study has also found that in general there has been no effect of public accountant rotation with audit quality. Ishak et al. (2015) has found that audit rotation has a negative effect on audit quality.

Audit rotation refers to research conducted by Siregar (2011). This variable uses dummy variable, where:

1: for the company which performs audit rotation

0: for the company which does not perform audit rotation

Tenure is the period of engagement between the auditor and the client regarding audit services as agreed in the term. Mautz and Shraft (1961) in Fitriany (2015) state the length of the relationship between the auditor and the client will affect the auditor's independence because the auditor's objectivity will decrease over time. Munif (2013) has argued that audit tenure itself is related to several things such as auditor competence, economic incentives, audit quality, and auditor independence.

There are two conflicting opinions about the relationship between tenure and audit quality (Fitriany, 2015). The first opinion is that the period of audit assignment is negatively related to the quality of the audit with the argument that the longer the audit period, the closer the relationship of the auditor and the client that it will affect the quality of audit (Chi and Huang, 2005; Davis et al., 2002; Geiger and Raghunandan, 2002). Al-Thunaebat (2011), Siregar (2011), Mgbame (2012), and Blandón and Bosch (2012) have found that audit tenure can reduce the audit quality. The second opinion is that the period of audit assignment is positively correlated with the quality of the audit. In other words, the longer the tenure, the better the audit quality will be (Myers et al., 2003). Audit tenure is measured by measurement in the study of Althuneibat et al. (2011) that is: $TEN = \sum$ the number of years a public accounting firm audited the same company.

Workload is a working condition that can precede and affect work stress levels. Setiawan and Fitriani (2011) state that the workload shows how much work an auditor faces. Pranoto and Retnowati (2015) state that workload is an action that aims to determine the amount of time required by employees to complete as job.

Workload can be seen from the number of clients to be handled by an auditor or the limited time available to carry out the audit process. Workload is also known as an audit capacity stress, referring to the pressure faced by the auditor in terms of the number of clients.

Hansen et al. (2007) have analyzed the effect of audit capacity stress on audit quality. The results of the research shows that a high level of audit capacity stress in a public accounting firm can reduce audit quality. Setiawan and Fitriany (2011) have also conducted research on the effect of workload on audit quality, and results showed that workload has a negative effect on audit quality. The same results are also shown by Lopez and Peters

(2012), that audit quality tends to decrease during the "busy season". However, different research results have been found by Ishak, Perdana, and Widjajanto (2015) that the workload has a positive effect on audit quality. In this case, the focus is on how a public accounting firm maintains its professionalism in conducting audits and improving audit quality.

This study follows Hansen et al. (2007), Setiawan and Fitriany (2011) and Ishak et al. (2015), which measure workload based on audit capacity stress with the following formula:

$$W = \frac{\sum \text{number of clients in KAP}_{it}}{\sum \text{number of partners in KAP}_{it}}$$

Based on the theories and previous research, then the framework in the present research can be described as follows:

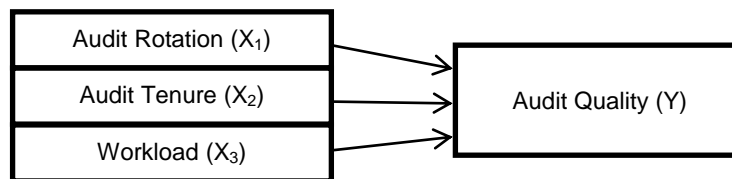


Figure 1 – Research Framework

METHODS OF RESEARCH

In this study, the data used was secondary data obtained from Indonesia Stock Exchange (IDX) available at BEI website or www.idx.co.id. Secondary data is in the form of financial statements and annual reports of manufacturing companies of consumer goods sector. Data of public accountants and registered public accountant offices (active) are obtained from IAPI and website of the Ministry of Financial i.e. the Center of Financial Profession Development.

The population in this study is 36 companies of consumer goods sector, and 26 companies were listed on the Indonesia Stock Exchange for a period of 5 years (2012-2016); the study involves 130 samples/observations. The criteria in sample selection are as follows:

- Companies listed in the period of 2012 to 2016;
- Companies have complete financial statements for overall measurement of variables;
- Companies use Indonesian Rupiah currency in the financial statements.

The data analysis is done using descriptive statistics, a classical assumption test, and hypothesis testing employing Eviews software. The purpose of this analysis is to know the influence of audit rotation (X_1), audit tenure (X_2), and workload (X_3) on audit quality (Y).

Wanner and Pevalin (2005) explain that panel regression is a set of techniques to model the effect of explanatory variables on response variables in panel data. Panel data is the result of observation on several individuals (unit of the cross table), each observed in several consecutive time periods (time unit) (Baltagi, 2005). Panel data was first introduced by Howles in 1950. Panel data is a combination of cross-table data and time series data. The cross-table data is a data consisting of a number of individuals collected at a given time, while time series data is data consisting of one individual but covering some periods of time.

Generally, using panel data will produce different intercept and slope coefficients on each individual and every time period. Based on the assumption of influence used in the panel data regression, the panel data regression model is divided into 3, i.e. Common Effect Model (CEM), Fixed Effect Model (FEM), and Random Effect Model (REM). Considering panel data is a combination of cross table data and time series data, the general form of panel data regression model is as follows:

$$y_{it} = \alpha + \beta X_{it} + \varepsilon_{it}; i = 1, 2, \dots, N; t = 1, 2, \dots, T \quad (1)$$

Where: y_{it} = Observation of the panel unit of the cross-table data of the i on t time; α = Intercept; β = Slope coefficient for all units; X_{it} = Independent variable for the i -th cross-table data of time t ; ε_{it} = Error value in the i cross-table data of time t ; i = Cross-section unit of N number; t = Number of t time.

To choose the most appropriate model in processing panel data, there are several tests that can be done such as the Chow test, Hausman test, and Lagrange Multiplier test (LM Test).

RESULTS OF STUDY

This research aims to study the influence of audit rotation, audit tenure, and workload on audit quality of the consumer goods sector listed on Indonesia Stock Exchange. The data is secondary data from financial reports of 26 consumer goods companies from 2012 to 2016. Descriptive and quantitative analysis is done to test the influence of audit rotation, audit tenure, and workload on audit quality of the consumer goods sector.

Based on descriptive analysis on audit quality variable from 26 companies, the maximum value of audit quality is 1.061800 or 106.18% from PT. Wilmar Cahaya Indonesia, Tbk (CEKA) in 2016 and the minimum value is -2.477920 or -247.79% from PT. Sekar Bumi, Tbk (SKBM) in 2012. The average value of audit quality from sample companies is -0.267782 or -26.77% with 0.532046 or 53.20% standard deviation.

Based on the descriptive analysis on audit rotation variable, we can see the maximum value of audit rotation is 1.000000 from 10 companies who perform audit rotation. The minimum value of audit rotation is 0.000000 from 16 companies who do not perform audit rotation. The average value for audit rotation is 0.115385 times with a standard deviation of 0.320721.

Based on the descriptive analysis, the maximum value of audit tenure from sample companies is 600% or 6.000000 and the minimum value is 100% or 1.000000 from 10. The average value for audit tenure is 3.384615 with a standard deviation of 1.567028.

Based on the descriptive analysis, the maximum value of workload is 131.00000. The average value from workload is 61.74755 with a standard deviation of 24.25648.

The CEM model estimation is as follows:

$$AQ = -1.244771 + 0.862735 RA + 0.263616 TEN + \varepsilon \quad (2)$$

Based on the above model equations, it can be seen that the variables which influence audit quality are audit rotation and audit tenure, where the coefficient value of each independent variable is positive, that is 0.862735 for audit rotation and 0.263616 for audit tenure. The FEM estimation is as follows:

$$AQ = -1.226644 + 0.841073 RA + 0.281634 TEN + \varepsilon \quad (3)$$

Based on the above model equations, it can be seen that the variables which influence audit quality are audit rotation and audit tenure, where the positive coefficient value is 0.841073 for audit rotation and 0.281634 for audit tenure. This means that if the audit rotation value increases by 1%, then the audit quality will increase by 0.84%, and if the audit tenure rises by 1%, then the audit quality value will also rise by 0.281634. The REM estimation is as follows:

$$AQ = -1.244771 + 0.862735 RA + 0.263616 TEN + \varepsilon \quad (4)$$

Based on the above model equations, it can be seen that the variables which influence audit quality are audit rotation and audit tenure, where the coefficient value is positive. This means that if the audit rotation value increases by 1%, then the audit quality will also increase by 0.86%, and if the audit tenure increases by 1%, then the audit quality value will also increase by 0.26%.

Based on the Chow, Hausman, and LM test, the CEM estimation has been chosen. Based on F test, the obtained p-value is less than the value of the significance level ($\alpha=0,05$). This means independent variables together affect the dependent variables. Based on *t-test*, individually/partially the audit rotation and audit tenure have a significant effect on audit quality. Workload does not have an effect on audit quality.

From the total observation of the pooled 130 data that has been estimated, it has been revealed that the audit rotation, audit tenure, and workload variables had a significant influence on audit quality. The evidence can be seen from the f-calculation value of 31.20497 with the probability value of f-calculation of 0.0000, where the value is smaller than the value α at 0.05 (5%)

Coefficient of determination (R²) has a value of 0.426268. The value reflects the squared value of the correlation coefficient R. The magnitude of the coefficient of determination value is equal to 42.6%. This figure explains that the contribution of audit rotation, audit tenure, and workload in explaining audit quality is only 42.6%, while 57.4% is explained by other variables outside of the model.

The value of adjusted R² is the coefficient of determination (R²) that has been correlated with the standard error value resulting in a value of 0.412608. Meanwhile, to determine that the regression model used is valid, we can see the comparison of standard error value (SE) of the regression model and the standard value of division response (SD). The comparison is proven by the value of SE at 0.407768 which is smaller than the value of SD at 0.532046, which means that the regression model is valid as a predictor model.

It has also been revealed that partially audit rotation and audit tenure have a significant influence on audit quality. This is evidenced by the probability value of t-calculation which is smaller than the value of α (significance level) of 0.05 (5%), that is $0.001 < 0.05$. Meanwhile, the workload shows no impact on audit quality because the probability of t-calculation is greater than the value of α at 0.05, that is $0.8741 > 0.05$.

The general panel data regression model is as follows:

$$AQ = -1.244771 + 0.862735 RA + 0.263616 TEN - 0.000240 WL + \epsilon \quad (5)$$

The above estimation results explain that the influence of independent variables on the dependent variable is as follows:

- Audit Rotation (RA). Statistically dominant influence on independent variables can be proven by looking at coefficient and t-calculation probability values such as the audit rotation variable with t-calculation value of 6.420970 and having a positive sign with the regression coefficient value of 0.862735; this means if audit rotation increases by 1%, audit quality will increase by 0.86%, assuming other variables are constant. Audit rotation has a positive effect on audit quality, that is, audit rotation can improve audit quality;
- Audit Tenure (TEN). Audit tenure has a t-calculation probability value, including audit rotation variable with t-calculation value, of 9.509330. The variable also has a positive sign with the regression coefficient value of 0.263616. This means if audit tenure rises by 1%, it will cause AQ to increase by 0.26%, assuming other variables are constant. Audit tenure has a positive and significant relationship with audit quality, meaning that audit tenure will improve audit quality. This is in accordance with research conducted by Fitriany (2015) showing that audit tenure has a positive relationship with audit quality;
- Workload (WL). The workload has a negative and insignificant relationship to the audit quality with the existing regression coefficient of -0.000240, meaning that if the workload variable increases by 1%, it will decrease the audit quality by 0.0002%. The higher the workload pressure, the lower the audit quality will be.

The results of hypothesis testing indicate that audit rotation has a significant effect on audit quality with a positive relationship direction. That is, audit quality will increase along with the increase in audit rotation. Audit rotation regulation increases auditor responsibility by

providing good capability in limiting management actions carried out by client company management, resulting in high audit quality. Audit rotation is one solution to overcome the problem of auditor independence because it maintains audit quality.

The results of this study are consistent with the research conducted by Ishak, Perdana, and Widjayanto (2015) stating that the regulations regarding auditor rotation aim to improve audit quality, assuming that the longer the relationship between audit partners (AP) and the public accounting firm with its clients will reduce auditor independence. According to and Firth et al. (2012) audit rotation can also affect audit quality. This is indicated by the auditor's ability to detect discretionary accruals carried out by management. However, in reality, there are still few companies that routinely conduct audit rotations annually, as found in this study.

Agency issues come from the auditor's side where auditors have the interest in maintaining and increasing the income of their audit services by fulfilling the wishes of clients, especially long-term ones. A long tenure audit will create closeness and loyalty between the auditor and the client. This will reduce audit objectivity and reduce auditor independence and is feared to affect audit quality.

The results of hypothesis testing indicate that audit tenure has a significant effect on audit quality with a positive relationship direction. That is, the tenure of the audit can improve audit quality. This is in accordance with the research conducted by Myers et al. (2003), Chen *et al.* (2008), and Fitriany (2015) revealing that audit tenure has a positive relationship with audit quality, in which the longer the tenure, the better the audit quality will be. The audit tenure will encourage the creation of business knowledge for an auditor. This knowledge can be used to design effective audit programs and create quality audit reports.

The resilience theory is defined as the human capacity to deal with, overcome, and even change due to traumatic experiences one experiences. When one's life is disturbed, they will try to not make the depression, hurt, anger, confusion, or other negative feelings as permanent traumatic experiences. They will rise to the many pressures and make it a challenge and then overcome them.

Auditors are required not only to work professionally, but also to complete the task timely. Quality reports demanded in such limited time have been a pressure for the auditor. The auditor must be able to maintain professionalism in conducting audits that the audit report issued is of high quality.

The results show that workload has a negative and not significant relationship to audit quality with the existing regression coefficient of -0.000240; this means if the workload variable increases by 1%, it will reduce audit quality by 0.0002%. This is consistent with the research conducted by Lopez (2005), Hansen *et al.* (2007), Setiawan and Fitriany (2011), Lopez and Petters (2012) and Persellin, Schmidt, and Wilkins (2014) that carrying an audit process with such workload pressures will result in lower audit quality compared to when there is no workload pressure. Overlapping audit assignments will create a separate workload for the auditor.

CONCLUSION

Audit rotation and audit tenure have a positive and significant impact on audit quality, that is, audit rotation can improve audit quality and longer audit tenure can improve audit quality. Workload has a negative and insignificant relationship to audit quality, meaning that the higher the workload pressure, the lower the audit quality will be. Companies should routinely perform audit rotation. According to the results of research that audit rotation will improve the audit quality. Companies should follow the regulations issued on the limitation of audit tenure that is for 6 consecutive years in accordance with the PMK No. 17 of 2008. This study only covers three variables (audit rotation, audit tenure, and workload) and involves only consumer goods sector as the sample. Thus, the following suggestions are presented for further studies. Further research is expected to add other research variables beyond audit rotation, audit tenure, and workload that can influence the audit quality. They may also involve samples on other types of companies in different periods.

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