



THE EFFECT OF AUDIT QUALITY, FIRM SIZE, AND EARNINGS GROWTH ON EARNINGS QUALITY AT NATIONAL AND LOCAL ENTERPRISES IN THE INDONESIA STOCK EXCHANGE

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ABSTRACT

The goal of this research is to see how audit quality, business size, and earnings growth affect earnings quality. The sample for this study is established through purposive sampling, and it consists of 25 state-owned enterprises listed on the Indonesia Stock Exchange, including financial statement data for the 2016-2020 financial years. Hypotheses are developed using agency theory and signal theory methodologies. The significance of the audit quality variable was 9.6%, the business size variable was 20.8 percent, and the profit growth variable was 0.1 percent, according to the findings of the t-statistical test with a significance level of 5%. According to the findings, audit quality and business size have no impact on earnings quality, while earnings growth has a considerable negative impact.

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1. INTRODUCTION

Article 12 letter b of the Law of the Republic of Indonesia Number 19 of 2003 concerning State-Owned Enterprises (BUMN) and Article 7 letter c of Government Regulation of the Republic of Indonesia Number 54 of 2017 concerning Regional Owned Enterprises (BUMD) states that BUMN and BUMD aim to obtain profit. Furthermore, Article 74 paragraph (2) of the Law of the Republic of Indonesia Number 19 of 2003 concerning BUMN and Article 115 paragraph (1) of the Government Regulation of the Republic of Indonesia Number 54 of 2017 concerning BUMD states that the privatization of BUMN and BUMD is carried out with the aim of improving performance and added value to the company and increasing public participation in share ownership in BUMN and BUMD in the form of a company company.

BUMN and BUMD, like other Indonesian businesses, have set a profit objective with the implementation of these restrictions. Furthermore, the demands of BUMN and BUMD to avoid burdening state and regional finances are becoming more forceful. BUMN and BUMD are intended to be able to secure their own funding rather than relying on the APBN/D (State/Regional Revenue and Expenditure Budget). On this premise, it is critical for BUMN and BUMD to increase the quality of their earnings so that they can attract community investors.

Earnings Quality, which is the study's dependent variable, is one piece of information that investors use to make judgments. Management policies influence the income information presented by management through financial statements, which means that management handles information that can be directed toward specific aims (Scott, 2015). Furthermore, earnings quality is a metric used to determine how well the information reported in the financial statements accurately reflects the company's current status. For example, the Enron bankruptcy occurred

because many things in the company's management were not transparently disclosed, particularly regarding the company's unhealthy financial condition, where Enron, as a public company, should be honest and transparent to the public, particularly its shareholders, in making financial reports.

Due to accounting and financial difficulties that indirectly affect public accountants, audit quality has once again captured the public's attention. There have been examples of Jiwasraya (involving Pricewaterhouse Coopers), SNP Finance (Deloitte), Indosat Ooredoo (Ernst & Young), Baker Hughes (KPMG), Garuda Indonesia (BDO), and others in Indonesia. Audit quality has been used as a proxy for a variety of variables in past research, including audit firm size, audit tenure, audit industry specialization, restatement, litigation, accruals, audit opinion, and so on (Hu, 2015). Audit quality is used as an independent variable in this study, with audit opinion proxies, audit firm size, and audit tenure being used.

Aryengki (2016) and Safitri&Afriyenti (2020) state that company size has no effect on earnings quality. Zatirah, Sifah&Erdawati (2020) state that company size has an influence on earnings quality. In addition to these differences of opinion, the varying sizes of BUMN and BUMD in the perspective of total assets owned encourage researchers to use company size as an independent variable in this study.

Many studies have been conducted regarding the effect of earnings growth on earnings quality, among others, by Kurniawan & Aisah (2020) which states that profit growth has a significant effect on earnings quality. In addition, earning a profit has become one of the performance indicators of BUMN and BUMD in Indonesia. On this basis, profit growth is used as the third independent variable in this study.

2. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Agency Theory

The definition of agency theory, according to Jensen & Meckling (1976), is a contract, interaction, or convention between one or more people (principals) and other people (agents) in which the principal delegates decision-making authority to the agent in order for the agent to perform several services for the principal. The shareholders have given management authority to make choices in the company's management. Agency Theory, according to Eisenhardt (1989), is founded on a number of assumptions that can be grouped into three categories: human nature, organization, and information. Human nature is said to emphasize that everyone is born greedy (self-interest), rationally constrained (bounded rationality), and prefers to avoid danger (risk averse).

Agency theory, according to Scott (2015), is a branch of game theory that investigates the framework of contracts that incentivize rational agents to act in line with the principal's objectives. An agency relationship exists when one party (principal) hires another party (agent) to perform services, and the principal delegated decision-making authority to the agent. In practice, though, disputes do arise from time to time since each partner has different interests. Agents frequently operate in their own best interests at the expense of the principal's. This is the source of conflict, which is referred to as agency conflict.

Signalling Theory

Starting with George Akerlof's work in the 1970 essay "The Market for Lemons," which coined the phrase "asymmetric information." By looking at the used automobile market, Akerlof (1970) investigated the topic of knowledge asymmetry in product quality between consumers and sellers. Akerlof (1970) found that if a consumer had no information about product specs and merely had a general concept of the product, he could buy both high-quality and low-quality products at the same price. Adverse selection is a condition in which one of the parties to a business transaction, the seller, has more information than the other party, the buyer (Scott, 2015). Akerlof (1970) argues that adverse selection can be reduced if the seller conveys the product by providing a signal in the form of information about the quality of the product.

Brigham & Houston (2018) commented on signaling theory as a company's effort to provide a signal to investors about the management's perspective on the company. According to Hartono (2017), signaling theory emphasizes how important the information issued by the company is on the investment decisions of parties outside the company. Information is an important element for investors and businesspeople because information essentially presents information, notes or descriptions for past, current and future conditions for the survival of a company and how the securities market will be. Complete, relevant, accurate and timely information is needed by investors in the capital market as an analytical tool for making investment decisions.

Earnings Quality

According to Wahlen, Baginski & Bradshaw (2016) earnings quality is earnings that can be used to make an accurate assessment of current performance and can be used as a basis for predicting future performance. In addition, quality earnings are earnings that are presented based on a balance sheet that allows an accurate assessment of key risks such as liquidity, financial flexibility and solvency.



According to Scott (2015) earnings quality is a criterion considered in measuring how far the information presented in the financial statements can describe the actual condition of the company. The information in the financial statements must be used to predict the company's performance in the next period. The relationship between the information presented in the current financial statements with the company's performance in the future shows the quality of earnings presented in the financial statements. Earnings quality refers to the relevance of earnings in measuring the level of company performance (Subramanyam, 2014).

According to Kepramareni, Pradnyawati&Swadewi (2021) earnings quality is an assessment of the extent to which a company's profits can be obtained repeatedly and can be controlled. Earnings quality recognizes the fact that the economic impact of the transactions that occur will vary between companies as a function of the basic character of the business and is variously defined as the rate of profit indicating whether the underlying economic impact is better at forecasting cash flows or is predictable. Karim (2019) said that the quality of earnings as measured by the relationship with cash flows from operating activities can describe the actual condition of the company.

Audit Quality

Arens et al. (2014) describes audit quality as the accuracy of assurance in finding material errors in the presentation of financial statements. The detection aspect reflects the auditor's ability and the report specifically reflects the ethics or integrity of the auditor, in particular. This reflects that independence.

According to the previous description, audit quality is the result of independent and procedural audit work in which the auditor finds and reports serious misstatements in the client's accounting system under specific circumstances. The following definition splits audit quality into two parts: (1) A misrepresentation may be discovered by the auditor. The auditor's capacity to discover misstatements reflects his or her competence to determine what intermediate steps are required. (2) Appropriate response to inaccuracies. This relates to the auditor's obligations to be objective, skeptical, and independent.

Firm Size

According to Brigham and Houston (2018), a company's size can be classified in a variety of ways, including the magnitude of its revenue, total assets, and total equity. A scale that can be seen from a company's or organization's total assets that arranges diverse resources owned with the goal of being able to generate goods or services for sale is known as company size.

According to Hartono (2017), the size of a firm may be determined by looking at the total assets of the company, which is then estimated using the logarithmic value of the total assets. According to some viewpoints, the usage of total assets is justified since total assets indicate the company's resources that can be managed to fulfill organizational objectives. As a result, the higher the company's assets, the better the company's potential to realize its objectives.

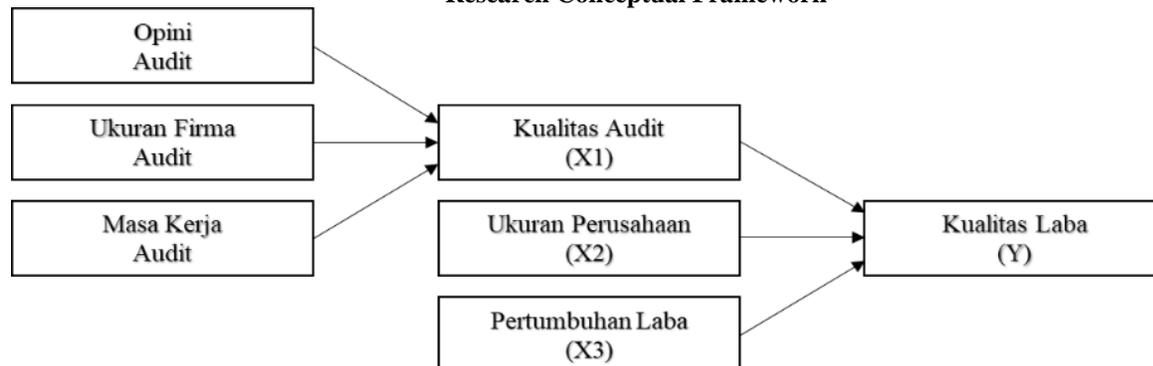
Earnings Growth

Profit, or net income, is a measure of a company's profitability, according to Subramanyam (2014). Earnings indicate the period's returns to equity investors, whereas items in the financial statements show how profits were achieved. The difference between income and expenses is known as net profit (Warren, Reeve & Duchac, 2018). The ability of a corporation to raise net profit from year to year is measured by profit growth (Ayem, Wahyuni&Suyanto, 2017). Profitable businesses can improve the relationship between their size and their profit margins. A big number of assets in a prosperous company will boost profitability opportunities and affect the quality of good earnings. Net income can be calculated by subtracting income from expenses (Sujarweni, 2017). Revenue is the growth or reduction in a company's total assets or liabilities as a result of the sale of goods or services within a given accounting period. Expenses are costs incurred to earn money over a period of time.

Thinking Framework

The justification for research is the framework of thinking, which combines theory with facts, observations, and a literature study (Unaradjan, 2019). This research looked at the impact of audit quality, business size, and earnings growth on earnings quality. The findings of the examination of audit opinion, audit firm size, and audit tenure are scored to determine audit quality. The natural logarithm of total assets is used to determine the size of a company. The difference between the current year's comprehensive income and the prior year's comprehensive income is used to calculate earnings growth.

Figure1
 Research Conceptual Framework



The Effect of Audit Quality on Earnings Quality

Previously, Suwito et al. (2021), Robik et al. (2021), Wijaya (2020), Sumiadji et al. (2019), and Indriani&Kusumaputra (2016) discovered that audit quality has an impact on earnings quality. Meanwhile, Puteri &Saraswati (2021) and Widodo &Fanani (2020) show that audit quality has little bearing on earnings quality.

Financial statement users, particularly shareholders, frequently base their decisions on information from the auditor's report. This means that the auditor's function in offering an opinion on a company's financial statements is critical, and the auditor must be able to conduct high-quality audits that demonstrate accuracy in detecting major errors in financial statement presentation. The auditor's ability to detect is reflected in the detection aspect (Arens et al., 2014). The initial hypothesis for this investigation is formulated as follows based on this explanation: **H1: Audit quality has a positive effect on earnings quality.**

The Effect of Firm Size on Earnings Quality

Many earlier researches have looked at the impact of firm size on earnings quality. Company size has an impact on earnings quality, according to Zatira et al. (2020), Anam&Afrohah (2020), Wijaya (2020), Liu &Skratt (2018), and Arisonda (2018). Firm size had no effect on earnings quality in other research by Safitri&Afriyenti (2020), Hakim &Naelufar (2020), Helina&Permanasari (2017), and Aryengki (2016).

According to Hartono (2017), the size of a corporation may be determined by looking at the size of the company's total assets. The use of total assets is based on the idea that total assets represent the company's resources that may be managed to meet organizational objectives. As a result, the higher the company's assets, the better the company's potential to realize its objectives. This is something that investors should think about when making judgments. The second hypothesis is phrased as follows: **H2: Firm size has a positive effect on earnings quality.**

The Effect of Profit Growth on Earnings Quality

Profit, or net income, is a measure of a company's profitability, according to Subramanyam (2014). Earnings indicate the period's returns to equity investors, whereas items in the financial statements show how profits were achieved. A big number of assets in a prosperous organization will boost profitability opportunities and effect good earnings quality (Ayem et al., 2017). Earnings growth has a beneficial effect on earnings quality, according to previous studies by Arif (2020), Harsono (2019), and Arisonda (2018). Furthermore, profit growth has little effect on earnings quality, according to Broad et al. (2021), Indrawan et al. (2020), and Hakim &Naelufar (2020). Earnings growth has a negative and significant effect on earnings quality, according to Anam&Afrohah (2020). The authors formulate the third hypothesis of their study as follows: **H3: Earnings growth has a negative effect on earnings quality.**

3. RESEARCH METHODS

Research Design

The correlational method with a quantitative approach is utilized in this study to quantify the effect of two or more variables using statistical methods (Creswell, 2016). Three independent variables and one dependent variable are used in this study. Purposive sampling, or the technique of determining the sample using particular factors, is used to determine the sample (Sugiyono, 2019). The data from published financial reports was used in this investigation. On financial statement data from the chosen sample, data is collected using documentation procedures. The IDX's official website provided statistics for the 2019-2020 fiscal year, whereas the official websites of each BUMN/BUMD provided data for the 2016-2018 fiscal year.



The documented data were then analyzed using multiple linear regression method. Multiple linear regressions are a regression model that involves more than one independent variable. Multiple linear regression analysis was conducted to determine the direction and how much influence the independent variable had on the dependent variable (Ghozali, 2018).

Dependent Variable

The link between accounting earnings and cash flows is one of the aspects of earnings quality. The earning quality ratio depicts the link between cash flow and net income, with a greater ratio indicating higher earnings quality since more operating profit is recognized in cash rather than accruals. As a result, high-quality earnings can be converted into cash (Darsono&Ashari, 2010). The following is the model used to determine earnings quality:

$$EQ = \frac{CFO}{EBIT}$$

Where:

- EQ = earnings quality
- CFO = Operational Cash Flow
- EBIT = *earning before income and taxes*

Independent Variable 1: Audit Quality

The audit quality is the first independent variable in this study. Audit quality, according to Hu (2015), is determined by factor scores derived from proxies derived from a variety of variables, such as audit firm size, audit tenure, audit industry specialization, restatement, litigation, accruals, audit opinion, and so on. Audit quality was calculated as an independent variable in this study utilizing factor analysis using audit opinion proxies, audit firm size, and audit tenure.

The score for audit opinion is used as in the study by Putra et al. (2021). Using the measurements used in the research of Sumiadji et al. (2019) and Puteri&Saraswati (2021), the size of the audit firm is measured using a dummy variable of 1 if the company is audited by a big 4 public accounting firm and vice versa using a dummy variable of 0 if the company is not audited by a big 4 public accounting firm. Audit tenure (period) indicates the number of consecutive years audited by the same audit firm, as used in the study by Sumiadji et al. (2019).

Table 1
Score of Factors to measure Audit Quality

Factor	Audit Opinion		Audit Firm Size		Audit Tenure	
Measurement	Score		Dummy Variable		Score	
	<i>Unqualified</i>	5	PAF Big 4	1	1 year	5
	<i>Unqualified with Explanatory Language</i>	4			2 consecutive years	4
	<i>Qualified</i>	3	PAF Non Big 4	0	3 consecutive years	3
	<i>Adverse</i>	2			4 consecutive years	2
	<i>Disclaimer</i>	1			5 consecutive years	1
Sources	Putra et al. (2021)		Sumiadji et al. (2019); Puteri&Saraswati (2021)		Sumiadji et al. (2019)	

Independent Variable 2: Firm Size

The second independent variable is firm size. Hartono (2017) argues that the size to determine the size of a company can be measured by looking at the size of the company's total assets which is then calculated using the natural logarithm value of the total assets. The size of the company in this study was calculated using the following formula:

$$UP = Ln(TA)$$

Where:
 UP = Firm Size
 Ln = Natural Logarithm
 TA = Total Company Asset

Independent Variable 3: Earnings Growth

The ability of a corporation to raise net income from year to year is measured by earnings growth (Ayem et al., 2017). Profitable businesses can improve the relationship between their size and their profit margins. A big number of assets in a prosperous company will boost profitability opportunities and affect the quality of good earnings. The profit growth model utilized in this study is the same as that used by earlier researchers, such as Arif (2020), Harsono (2019), and Arisonda (2018), and is as follows:

$$PL = \frac{CI^t - CI^{t-1}}{CI^{t-1}}$$

Where:
 PL = Earnings Growth
 CI^t = *Comperehensive Income* in the current financial year
 CI^{t-1} = *Comperehensive Income* in the previous financial year

Analysis Technique

The data analysis method used in this research is descriptive analysis, confirmatory factor analysis, classical assumption test, multiple linear regression, correlation test & determination test and hypothesis testing. Processing of statistical tests for this study was carried out with the IBM SPSS Statistics version 26 application tool.

Multiple Linear Regression Model

Multiple linear regressions are a regression model that involves more than one independent variable. Multiple linear regression analysis was conducted to determine the direction and how much influence the independent variable had on the dependent variable (Ghozali, 2018). The regression equation model developed by the author in this study is:

$$EQ = a + \beta_1AQ + \beta_2UP + \beta_3PL + \varepsilon$$

Where:
 EQ = *Earnings Quality*
 a = Constant
 β1, β2, β3 = Regression Coefficients
 AQ = *Audit Quality*
 UP = Firm Size
 PL = Earnings Growth
 ε = error

4. RESULTS AND DISCUSSION

General Description

Based on the results of documentation from the official website of the Ministry of SOEs of the Republic of Indonesia and the official website of the Indonesia Stock Exchange (IDX), 125 data were obtained from 25 companies (consisting of 21 BUMN and 4 BUMD) that were sampled in this study.

4.1. Result

Descriptive Analysis Results

The results of the descriptive analysis of the dependent and independent variables used in this study can be seen in table 2.

Table 2
Descriptive Analysis Results

		Audit Quality	Firm Size	Earnings Growth	Earnings Quality
N	Valid	125	125	125	125
	Missing	0	0	0	0
Mean		9.1360	3.4478	-0.0050	1.0125
Std. Error of Mean		0.1230	0.0051	0.0043	0.0047
	Mean	9.3821	3.4580	0.0035	1.0218



		Audit Quality	Firm Size	Earnings Growth	Earnings Quality
	Distribution +				
	Mean Distribution -	0.08899	3.4376	-0.0136	1.0031
Median		9,0000	3.4529	0.0016	1.0087
Mode		10.0000	3.3053	-0.1786	0.8341
Std. Deviation		1.3757	0.0569	0.0477	0.0523
Variance		1.8926	0.0032	0.0023	0.0027

Source: SPSS Processed Data by Researcher, 2022

N represents the amount of data. The table shows that N is 125 data for each variable without missing data. It means that all data can be used for research.

Result of Confirmatory Factor Analysis

The confirmatory factor analysis was carried out in two steps. Because the KMO score was 0.4810 in the first stage, it did not match the criterion because it was less than 0.5. The Audit Opinion MSA score is 0.4370, the Audit Firm Size MSA score is 0.4870, and the Audit Term MSA score is 0.4850. The MSA scores were all less than 0.5, indicating that none of them satisfied the criterion. Furthermore, because the Audit Opinion has the lowest MSA score of 0.4370, it is provided at the following analytical stage.

In the second step, the study is limited to two variables: the size of the audit firm and the length of time the firm has been in business. It fits the criterion since the KMO value is 0.5000 and the probability value is 0.0490. Both components have an MSA score of 0.5000 and a communal value of 0.5880, thus they both match the criterion. The eigenvalues score for Audit Firm Size is 1.1760, and the eigenvalues score for Audit Working Period is 0.8240. The Audit Period is excluded from the study because the eigenvalues score is larger than one. Following that, the loading factor for Audit Firm Size is 0.767, which is more than 0.4 and thus meets the criterion.

Based on the results of each stage of the confirmatory factor analysis mentioned above, to measure the audit quality variable, a score from the size of the audit firm is used.

Result of Normality Test

The results of the normality test on the residual value of the research variables are 0.078 so that it is greater than 0.050 and the data can be concluded to be normally distributed.

Multicollinearity Test

The correlation coefficient between the three independent variables is entirely smaller than 0.80, according to the Pearson test results. The VIF scores for the factors of Audit Quality, Firm Size, and Profit Growth are 1.717, 1.704, and 1.013, respectively, according to the VIF test results. As a result, the VIF score for the three variables is less than 10, and the criteria are met.

Based on the findings of the Pearson test and the VIF test, it can be stated that the independent variables employed in this study are not multicollinear.

Heteroscedasticity Test

The absolute number of the residual value of the research regression model was employed as the dependent variable in the Glejser test process to test heteroscedasticity. The significant value of all independent variables is larger than 0.05, according to the results. These findings show that the regression model utilized in this investigation has no heteroscedasticity.

Multiple Regression Model Equation

Based on the results of the calculation of the regression coefficient using IBM Statistics Version 26, it is known that the constant in the regression model is 1.451 and the coefficient for Audit Quality is 0.0200, Company Size is -0.1310 and Profit Growth is -0.3170. Based on the model developed in this study, the following regression model equation was obtained:

$$EQ = 1,451 + 0,02AQ - 0,131UP - 0,317PL$$

The equation shows that the higher the audit quality, the higher the earnings quality, or indicates a positive relationship. On the other hand, the larger the firm size and earnings growth, the lower the earnings quality, or indicates a negative relationship.

Correlation Test Results (R) and Coefficient of Determination (R²)

The ability of audit quality to explain earnings quality is 65 percent (R=0.65), the ability of company size to explain earnings quality is 43 percent (R=0.43), and the ability of earnings growth to explain earnings quality is 27.8 percent (R=0.278), according to the correlation coefficient test (R). The determinant coefficient is 0.099, indicating that audit quality, firm size, and earnings growth may all explain 9.9% of earnings quality, with the remaining 90.1 percent explained by other independent variables not considered in this study.

Model Feasibility Test Results (Statistical Test F)

The F test results reveal that the estimated F is 4.426, which is more than the F table's value of 2.6795 and hence meets the criterion. F has a significance value of 0.005, which means it is less than 0.05 and hence meets the criterion. As a result, it can be concluded that the model utilized is suitable for study and has a combined impact on earnings quality.

Individual Parameter Significance Test Results (Test Statistics t)

The audit quality variable has a t-value of 1.6760 with a significance of 0.0960 or 9.6 percent, which is more than 0.05 and rejects H1. H2 is rejected because the company size variable has a t value of -1.2660 with a significance of 0.2080 or 20.8 percent, which is more than 0.05. H3 is acceptable since the profit growth variable has a t value of -3.310 and a significance of 0.0010 or 0.1 percent, which is less than 0.05.

4.2. Discussions

The t-test results show that H3 is acceptable; indicating that profit growth has a negative and significant impact on earnings quality. The findings of this study back with prior research by Anam and Afrohah (2020), who found that earnings growth has a negative and significant impact on earnings quality. Furthermore, the findings of this study contradict recent research by Arif (2020), Harsono (2019), and Arisonda (2018), which found a favorable relationship between earnings growth and earnings quality. Furthermore, profit growth has little effect on earnings quality, according to Broad et al. (2021), Indrawan et al. (2020), and Hakim and Naelufar (2020). In this study, earnings quality is calculated using earnings quality, which shows that the greater the growth of comprehensive income, the smaller the operating profit realized in cash, resulting in higher accruals, whereas the smaller the growth of comprehensive income, the greater the operating profit realized in cash, resulting in smaller accruals.

5. CONCLUSION AND RECOMMENDATIONS

It can be inferred as follows based on the results and analysis offered in the previous section:

- a. Earnings quality of BUMN and BUMD listed on the Indonesia Stock Exchange is unaffected by audit quality.
- b. The earnings quality of BUMN and BUMD, both listed on the Indonesia Stock Exchange, is unaffected by the firm size.
- c. Earnings growth has a negative and considerable impact on the earnings quality of BUMN and BUMD listed on the Indonesia Stock Exchange.

The following are some of the suggestions made:

- a. The firm's management is expected to improve the company's earnings quality so that favorable information about the company's performance will encourage investors to make investment decisions for the company. Management must improve the company's entire quality rather than focusing solely on profit, including service quality, debt quality, and other factors that might boost investor trust.
- b. When evaluating earnings quality as a basis for investing decisions, investors should consider more than one criterion. The findings of this study show that audit quality, business size, and profits growth all have an impact on earnings quality, but investors must also examine other factors, such as external financial statements, when making investment decisions.
- c. It is hoped that future researchers would be able to use a more diverse sample of organizations in future studies on earnings quality, as well as increase the factors and proxies for the variables used in the study.

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