# THE ROLE OF AUDIT COMMITTEE STATUS, REGULATIONS OF PUBLIC ACCOUNTING FIRMS, INDEPENDENCY OF BOARD OF COMMISSIONERS, AND INSTITUTIONAL OWNERSHIP IN IMPROVING THE QUALITY OF FINANCIAL STATEMENTS

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**ABSTRACT**

*This study aims to examine the effect of audit tenure regulations, interactions between status and background of the audit committee, audit quality, the independence of the board of commissioners, and institutional ownership on the quality of financial statements. The audit tenure regulations pursuant to the Regulations of the Minister of Finance of the Republic of Indonesia Number 17/PMK.01/2008 were issued in 2008. After the issuance of the regulations, the quality of the financial statements is expected to be improving compared to years preceding. The roles of status and backgrounds of the audit committee are also expected to improve the supervision effectiveness of the financial statements. The quality of financial statements is measured using accruals quality as reflected in the relationship between working capital accruals and operating cash flow. The sample firms are companies listed in Indonesia Stock Exchange (IDX) in the period of 2005-2011. However, the data in 2008 were not used, because it was the year of the issuance of the audit tenure regulations issued by the Minister of Finance. This study contributes to investors and potential investors by providing an overview of the companies that have good corporate governance. This study also contributes to the Minister of Finance to continuosly improve the quality of their regulatory systems. On top of that, this study is expected to contribute to the development of regulations governing public accountant in Indonesia. The results, overall, showed that audit tenure regulations, interactions between status and backgrounds of the audit committee, audit quality, and institutional ownership have a positive effect on the financial statements quality. However, the independence of the board of commissioners has no effect on the financial statements quality.*

Keywords: Financial statements quality, accruals quality, audit committee status, audit tenure regulations

## INTRODUCTION

Financial statements are beneficial to investors because they can help them make business and economic decisions. The quality of decision making increases when the financial statements information reflects all the economic events of the company well, so they are relevant and reliable in making decisions. Thus, the quality of financial statements determines the quality of decision making. The financial statements are the product of an accrual basis of accounting. Accrual accounting requires managers to use discretion in estimating the value of transactions in which settlements depend on the circumstances that occur in the future. As a result, both accidental and unintended estimates of errors are most likely to occur in the financial statements. The quality of financial statements is largely determined by the accuracy in reporting accrued items and reflected from the quality of the accrual component in the reported earnings.

According to Dechow and Dichev (2002), accrual quality is reflected from the relationship between working capital accrual and operating cash flow of the company. Changes in working capital accrual will be reflected in the realization of the past, present, or future operating cash flows. Under ideal conditions, the changes in the working capital accrual should be matched with the changes in the operating cash flow. This condition indicates that the less accrual estimation errors, the higher the accrual quality will be. Conversly, when the changes in working capital accrual are not propotional to the changes in the operating cash flow, the more estimation errors, the lower the accrual quality in the financial statements will be.

For instance, a company sells on credit for 100 rupiah in period t, the company will recognize a receivable against the sale income of 100 rupiah, with the estimate that the probability of this receivable will be fully repaid in the next period (t + 1). When in the period t + 1 the settlement of accounts receivable is only 70 rupiah, then the cash flow only increases by 70 rupiah, while the receivable increased by 100 rupiah. Therefore, 30 rupiah (difference between accrual estimation and cash flow realization) is detected as an estimation error. This means that the recognition of receivables amounting to 100 rupiah is not appropriate, so that the receivable as a component of working capital is not fully realized in the cash flows of the next period. Conversely, when there is a settlement of 100 rupiah in the period t + 1, no estimation error is found (Dechow and Dichev, 2002).

In 2017, the Financial Services Authority of Indonesian revealed that the implementation of Indonesia firms corporate governance is still lagging behind than other countries in Asia. There are only two firms from Indonesian were listed in the 50 best companies in the implementation of good corporate governance in Asean. Man (2013) found that good corporate governance can reduce earning management. The study stated that the role of corporate governance mechanisms such as boards of directors, the independence of the board of commissioners, audit committee, stakeholder were able to increase the role of oversight the internal control for financial reporting processes and increase the quality of corporate financial information. Not many Indonesian companies were aware of the importance of implementing corporate governance so that good corporate governance practices have not been attached to the company's vision and mission in running their business. Therefore, researcher is interested to examine the role of corporate governance mechanisms on the quality of financial statement.

External auditors play an important role in ensuring the quality of financial statements. In order to improve the quality of auditing services, the Ministry of Finance issued the Regulation of the Minister of Finance of the Republic of Indonesia Number 17 /PMK.01/2008 regarding the services of public accountant. Article 3 states that the maximum period of engagement between clients and public accounting firms is six consecutive years and between clients and public accountants shall be no longer than three consecutive years. One of the objectives of this study is to examine whether the regulation of audit tenure based on the Regulation of the Minister of Finance of the Republic of Indonesia Number 17/PMK.01/2008 has a positive effect on the quality of financial statements of public firms. After this rule was published in 2008 the quality of the financial statements is expected to increase compared to the years preceding.

Audit committees also play an important role in maintaining the integrity of financial statements. In general, the role of the audit committee in improving the quality of financial statements is measured using the audit committee's educational background. However, this study adds to the status of the audit committee that is supposed to improve the financial reporting supervision function. Status is embedded in an audit committee that has experience serving as a board of directors in a public or private company, meaning that the audit committee has experience to manage a company so it is assumed to understand the business process of the experience. The researchers added the audit committee status variables because some previous research results on the relationship between the audit committee background and the quality of the financial statements showed inconsistent results. Abbott et al. (2002) concluded that an audit committee with expertise in finance is required to strengthen the monitoring function of the financial reporting process. Xie et al. (2003) also found that audit committees with a financial background will reduce earnings management. While Prastiti and Meiranto research (2013); Pamudji and Trihartati (2010); Dhaliwal et al. (2006) found that audit committee expertise in finance did not affect the quality of financial statements. The results of Badolato et al. (2014) proved that the background and status of the audit committee could limit the actions of earnings management.

The size of the Public Accounting Firms become a factor that may affect the quality of the audit services provided. The Big Four auditors are believed to be able to provide auditing services independently and professionally, so they have good reputations and high audit qualities. Myers et al. (2003) suggests that Big Four auditors can limit excessive discretionary accruals of management compared to Non Big Four auditors. The existence of independent board of commissioners and institutional investors are also parts of good corporate governance mechanisms. According to Fama and Jensen (1983), effective supervision of independent board of commissioners may limit management interests and reduce agency costs, as a result of differences in interests between the management and shareholders. Meanwhile, Chung et al. (2005), argues that institutional investors with high shareholding levels are more active and motivated to conduct surveillance. Velury and Jenkins (2006) show that institutional investors can improve earnings quality.

This study contributes to investors and potential investors by providing an overview of companies that have good corporate governance. The result showed that the role of background and status of the audit committee, the role of Big Four public accounting firms, and the role of institutional investors can improve the quality of financial statements. So when a company have these three of corporate governance mechanisms, it is assumed that the company has good governance so as to produce more qualified financial statements. Therefore, the result of this study help investors assess the quality of financial statements. This study also contributes to subsequent researchers through empirical evidence to reinforce the existing empirical theory, so that it can be used as a reference in re-testing of research variables and research improvements.

This study aims to examine the effect of corporate governance mechanisms, especially the role of audit committee status and the impact of changes in regulations of audit tenure in improving the quality of financial statements. Thus, researcher is interested in conducting research entitled **"The Role of Audit Committee Status, Regulations of Public Accounting Firms, Independence of the Board of Commissioners, and Institutional Ownership in Improving the Quality of Financial Statements"**.

## LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

### AGENCY THEORY

According to Jensen and Meckling (1976), agency theory is a theory that explains the contractual relationship between management (agent) and shareholders (principal) within the company. The objective is to align the differences of interests between management and shareholders, so that management performs work in accordance with the interests of shareholders.

### HYPOTHESES DEVELOPMENT

### REGULATIONS OF AUDIT TENURE

According to Carcello and Nagy (2004), a long relationship between public accounting firms and client will decrease auditors' honesty and objectivity as it raises a sense of satisfaction for the auditor when the client gains a good reputation by having strong financial reporting controls, accurate financial statements, and top management with integrity. If the auditors assume that the reputation will continue in the future, the auditor will become negligent and the auditors' skepticism will decline throughout the audit engagement period. In addition, the external auditors will perceive the clients as a source of income that will persistently make the auditors have an expectation of having a longer relationship with the clients.

In order to overcome the threat of independence, Minister of finance issued the Regulations of the Minister of Finance of the Republic of Indonesia Number 17/PMK.01/2008 regarding the services of public accountants in 2008. Article 3 of the regulations states that the maximum period of engagement between the client and the firms is six years in a row. According to Siregar et al. (2011), at the beginning of the audit assignment to the optimal period of time, the quality of the audit will increase as it is more influenced by the increasing auditors' competence. However, after passing the optimal period of assignment, the quality of the audit will decrease because independence will further affect the quality of audit services provided compared to the auditor's competence. Therefore, it is assumed that the duration of six-year audit assignment is an ideal auditing period for auditors to improve their knowledge of the clients' businesses and maintain their independence. Carey (2006) found that longer audit tenure will degrade the quality of audit demonstrated by a smaller possibility for the auditor to report an on going concern opinion. Asare and Abdolmohammadi (2015) found that the period of the audit assignment of up to nine years or more will increase the likelihood of fraudulent financial statements. Thus, the relationship between the audit tenure regulations and the quality of the financial statements is stated in the alternative hypothesis:
**H1 : The quality of financial statements is higher after the issuance of the regulations regarding audit tenure in 2008**

### BACKGROUND AND STATUS OF THE AUDIT COMMITTEE

Previous research on the relationship between the audit committee's background and the quality of the financial statements shows inconsistent results leading to the assumption that audit committee's status variable also influences the relationship between the audit committee background and the quality of the financial statements. Badolato et al. (2014) found that the audit committee should also have status, because audit committee's expertise alone can not reduce earnings management. According to D'Aveni (1990) and Pollock et al. (2010), status affects the way managers view the audit committee, because status enhances the competence and authority of the audit committee. Accounting or finance background help the audit committee to understand the financial reporting processes, identify any financial issues, and ask appropriate questions to the management and auditors regarding the issues. Meanwhile, status means experience in managing a company that makes the audit committee has a leadership skills, so that the audit committee has the power and charisma to encourage the management to do the right financial reporting processes. Thus, the relationship between status and expertise of the audit committee and the quality of financial statements is stated in the alternative hypothesis:
**H2 : Interactions between status and background of the audit committee have a positive effect on financial statements**

### AUDIT QUALITY

Francis et al. (1999) found that the Big Six accounting firms were able to increase the credibility of corporate earnings by limiting the aggressive accrual rate in the financial statements so as to improve the quality of earnings. This is because the Big Six accounting firms have better techniques for detecting every problem, use the accounting policies wisely, and execute better negotiations with clients on financial statement regulations. Therefore, the Big Six accounting firms, which

is currently called as the Big Four, are assumed to be more qualified than Non Big Four accounting firms. Becker et al. (1998) found that firms audited by the Big Four accounting firms had less abnormal accruals than firms audited by Non Big Four accounting firms. Teoh and Wong (1993) found that earning response coefficient (ERC) was higher when firms audited by the Big Eight accounting firms than when audited by the Non Big Eight accounting firms. Thus, the audit quality relationship and the quality of financial statements is state in the alternative hypothesis:
**H3: The quality of the companies' financial statements using the Big Four public accounting firms' audit services is higher than that of the Non Big Four firms' audit services**

## THE INDEPENDENCE OF THE BOARD OF COMMISSIONERS

As an independent party, the board of commissioners is free from all interests in the company so as to make independent decisions for the companies. Chtourou et al. (2001) suggested that firms with independent board members have lower levels of discretionary accruals. According to Fama and Jensen (1983), the outside board of commissioners will maintain and enhance their reputation as an expert in supervising and controlling each decision so as not to damage their reputation. It is assumed that the supervision will be more effective. Wang and Campbell (2012) found that an independent board of directors can reduce earnings management. Sahlan (2010) also found that earnings management becomes smaller when more independent board members participate in conducting supervisory duties. Thus, the relationship between independent board of commissioners and the quality of financial statements is stated in the alternative hypothesis:
**H4: The independence of the board of commissioners has a positive effect on the quality of financial statements.**

## INSTITUTIONAL OWNERSHIP

Velury and Jenkins (2006) provide evidences that institutional investors can improve the corporate earnings quality. According to the Velury and Jenkins (2006), there are two reasons that encourage institutional investors to exercise better oversight of the financial reporting processes. First, financial statements are a relevant source of information about the companies that institutional investors use to plan and evaluate their investments. Second, institutional investors have better capabilities than individual investors to comprehend and analyze financial statement information comprehensively. Therefore, it is assumed the investors are able to detect errors which are deliberately done by the management. Chung et al. (2005) argued that institutional investors with high shareholding rates will be more active to exercise oversight. Koh (2007) also found that long-term institutional investors can monitor opportunistic actions of managers in companies which have the motivation to manipulate earnings to meet or beat the earnings benchmark. Thus, the relationship between institutional investor ownership and the quality of financial statements is stated in the alternative hypothesis:
**H5: Institutional investors ownership has a positive effect on the quality of financial statements.**

## POPULATION AND SAMPLE

Here are the criteria in sampling:

1. The companies were listed on the Indonesia Stock Exchange (IDX). In addition, they need to present complete and consistent financial statements during 2001-2012. However, for hypothesis testing, the researcher only used the data from 2005-2011. The data which were needed to calculate the residual standard deviation from the cash flow change regression which is the proxy of the financial statements quality, requires the companies to have four residual values derived from the previous years. Therefore, this study required data from 2001-2012. The data from 2008 were not used for the hypothesis testing, because it was as an event period in which the Regulations of Minister of Finance were issued.
2. The companies were not included in the financial and insurance industries. Both industries were excluded from the sample, because they have different accrual characteristics (Chtourou, 2001).
3. Information on the status and background of the audit committee were available in the annual reports.

**Table 1 : Sample Selection Criteria**

| Information | Years | | | | | | Total |
|---|---|---|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2009 | 2010 | 2011 | |
| Companies listed on the IDX and publish financial statements respectively starting from 2001-2012 | 273 | 194 | 164 | 232 | 256 | 246 | 1365 |
| Company financial statements included in the financial and insurance industries | (62) | (65) | (69) | (69) | (71) | (73) | (409) |
| The unavailability of the information on the status and background of the audit committee | (165) | (67) | (11) | (31) | (53) | (45) | (372) |
| **Annual statements used as sample** | 46 | 62 | 84 | 132 | 132 | 128 | 584 |

## SOURCES AND TYPE OF DATA

This study was an empirical study using secondary data obtained from the Annual Statement in the period of 2001-2012. The sources used to obtain observation data were the website of Indonesia Stock Exchange (www.idx.co.id), companies' websites, and Capital Market Information Center (PIPM) Semarang.

## OPERATIONAL DEFINITIONS AND VARIABLES MEASUREMENTS

### DEPENDENT VARIABLE

Qualified financial statements are financial statements that complied the four criteria of qualitative characteristics of financial statements that are understandable, relevance, reliability, and comparable. Accruals quality was used as a proxy for the quality of financial statements. Accruals quality refers to the accuracy of selection of estimates in recording all transactions or events presented in the financial statements. Accruals quality is determined by the magnitude of the accruals estimation errors reflected in the residuals standard deviation ($\varepsilon_1$) from the last year, present, and on year ahead of the operating cash flow change regression. Higher residual standard deviations indicate greater accrual estimation errors and lower accruals quality reflected in the reported earnings. In contrast, lower standard deviations indicate less accrual estimation errors and higher accrual quality. To simplify the interpretation of the regression results to be used as the basis for rejecting or accepting the hypothesis, the residual standard deviation values were multiplied by minus one (-1), so that high residual standard deviation values reflect high quality of financial statements as well. According to Dechow and Dichev (2002), changes in working capital can be calculated using the following formula:

$$\Delta Work\_Cap_t = b_0 + b_1 Cash\_Flow_{t-1} + b_2\, Cash\_Flow_t + b_3\, Cash\_Flow_{t+1} + \varepsilon_1$$

Information :

| | |
|---|---|
| $\Delta Work\_Cap_t$ | = current period working capital changes |
| $Cash\_Flow_{t-1}$ | = past cash flow |
| $Cash\_Flow_t$ | = present cash flow |
| $Cash\_Flow_{t+1}$ | = future cash flow |
| $\varepsilon_1$ | = error |

Changes in working capital can be calculated using the following formula (Dechow and Dichev, 2002):

$$\Delta Work\_Cap_t = -(\Delta AR + \Delta Inventory + \Delta Other\ assets - \Delta AP - \Delta TP)$$

Information :

| | |
|---|---|
| ΔAR | = account receivable changes |
| ΔInventory | = inventory changes |
| ΔOther assets | = other assets changes |
| ΔAP | = account payable changes |
| ΔTP | = tax payable changes |

### INDEPENDENT VARIABLE

### AUDIT TENURE REGULATIONS

Audit tenure regulations were issued in 2008, so, in this study, the researcher used 2008 as the event period. The impact of the regulations was assessed by comparing the quality of financial statements before and after the issuance of the regulations. Audit tenure regulations variable is a dummy variable. The companies' financial statements in the period of 2009-2011, in which the regulations had been issued, were denoted as 1. The financial statements in the period of 2005-2007, in which the regulations had not been issued, were denoted as 0.

### STATUS AND BACKGROUND OF THE AUDIT COMMITTEE

Status is the people's perception towards individuals' abilities to show good performances, because they have skills and personal characteristics that have been proven through their experiences. According to Badolato (2014), the audit committee are seen to have a status if they meet one of the two criteria – previously served as a board of directors of public or private companies. The status of the audit committee is a dummy variable. Firms with the audit committe who have status will be denoted as 1 and companies with the audit committee that do not have status will be denoted as 0.

The background of the audit committee referes to the audit committee's expertise in finance or accounting. According to Dhaliwal et al. (2006), accounting expertise was derived from work experience as a certified public accountant, chief financial officer, financial controllers, or other accounting positions. The expertise in finance comes from work experience as an investment banker, financial analyst, or other financial management positions. According to Badolato et al. (2014), the audit committee's background can be calculated using the following formula:

$$AC\_Background = \frac{\text{Numbers of the audit committee with accounting or financial expertise}}{\text{Total members of the audit committee}}$$

### AUDIT QUALITY

Audit quality is an audit process conducted independently and professionally in order to produce quality output, and can increase the users' confidence regarding the quality of financial statements. Audit quality variable is a dummy variable categorized by the size of public accounting firms. Companies audited by the Big Four will be denoted as 1, while companies audited by the Non Big Four will be denoted as 0.

**THE BOARD INDEPENDENCE OF OF COMMISSIONERS**

The board independence of commissioners is the extent to which the board of commissioners can free themselves from managerial pressure and interventions. Sahlan (2010) measures this variable by dividing the proportion of the independent board of commissioners by the total of the board of commissioners.

$$\text{Ind\_BC} = \frac{\text{Total of the independent board of commissioners}}{\text{Total of the board of commissioners}}$$

**INSTITUTIONAL OWNERSHIP**

Institutional ownership is the share amount of shares owned by institutional investors. Koh (2007) suggests that institutional ownership can be calculated using the following formula:

$$\text{Ins\_Own} = \frac{\text{Shares owned by insitutional investors}}{\text{Total shares of the company}}$$

**MULTIPLE REGRESSION TEST**

$$\text{Accruals\_Quality}_{it} = \beta 0 + \beta 1\ \text{AT\_Regulations}_{it} + \beta 2\ \text{AC\_Status}_{it}\ x\ \text{AC\_Background}_{it} + \beta 3\ \text{Audit\_Quality}_{it} + \beta 4\ \text{Ind\_BC}_{it} + \beta 5\ \text{Ins\_Own}_{it} + e$$

Information:

$\text{Accruals\_Quality}_{it}$ = Accruals quality of the company i in t year

$\text{AT\_Regulations}_{it}$ = Audit tenure regulations of the company i in t year

$\text{AC\_Status}_{it} x \text{AC\_Background}_{it}$ = Interactions between status and background of the audit committee of the company i in t year

$\text{Audit\_Quality}_{it}$ = Audit quality of the company i in t year

$\text{Ind\_BC}_{it}$ = The independence of the board of commissioners of the company i in t year

$\text{Ins\_Own}_{it}$ = Institutional ownership of the company i in t year

**ANALYSIS RESULTS AND DISCUSSIONS**

**Table 2: Descriptive Statistic**

| Variables | N | Minimum | Maksimum | Mean | Std Deviations |
|---|---|---|---|---|---|
| AC_Background | 229 | .250000 | 1.000000 | .76810153 | .239384953 |
| Ind_BC | 229 | .200000 | 1.000000 | .42387017 | .140299510 |
| Ins_Own | 229 | .300000 | .960000 | .71611354 | .153360615 |
| Accruals_Quality | 229 | -.079545 | -.000061 | -.02530904 | .014184883 |

The average of the audit committee's background is 0.7681. The minimum value is 0.25 and the maximum value is 1.00. It is implied that the smallest number of the audit committee whose having a financial or accounting background is 25% and there are sample companies whose all audit committee having financial or accounting background.

The average of the independent board of commissioner (Ind_BC) is 0.4238. The minimum value is 0.20 and the maximum value is 1.00. It is implied that the smallest number of the independent board of commissioners in sample companies is 20% and there are sample companies whose all members are independent board of commissioners.

The mean of the institutional investors' shares (Ins_Own) is 0.7161. It is implied that the average number of institutional investors' shares is 71.61%. The minimum and maximum value is 0.3 and 0.96. It indicates that the largest number of shares owned by the institutional inverstors is 96% and the smallest is 30%

The mean of accruals quality is -0.0253. The minimum value is -0.0795 and the maximum is -0.00006. To simplify the interpretation of the regression results used as the basis for rejecting or accepting the hypothesis, the residual standard deviation values are multiplied by minus one (-1), so that the average, minimum, and maximum values of the accruals quality become negative. Before the standard deviation values were multiplied by minus one (-1), the minimum value was 0.00006 and maximum value was 0.0795.

**Table 3: Descriptive Statistic of the Audit Tenure Regulations Variable**

| | | Frequency | Percentage | Valid Percentage | Cumulative Percentage |
|---|---|---|---|---|---|
| Valid | .00000 | 69 | 30.1 | 30.1 | 30.1 |
| | 1.00000 | 160 | 69.9 | 69.9 | 100.0 |
| | Total | 229 | 100.0 | 100.0 | |

The regulations of audit tenure variable is a dummy variable. Denotation 1 with the mean of 69.9% is the financial statements of the sample companies in the period of 2009-2011. In addition, denotation 0 with the mean of 30.1% is the financial statements of the sample companies in the period of 2005-2007.

**Table 4: Descriptive Statistic of Audit Quality Variable**

| | | Frequency | Percentage | Valid Percentage | Cumulative Percentage |
|---|---|---|---|---|---|
| Valid | .00000 | 120 | 52.4 | 52.4 | 52.4 |
| | 1.00000 | 109 | 47.6 | 47.6 | 100.0 |
| | Total | 229 | 100.0 | 100.0 | |

The audit quality variable is a dummy variable. Denotation 1 with the mean of 47.6% referes to the sample companies which use audit services provided by the Big Four auditors. Denotation 0 with the mean of 52.4% referes to the sample companies which use audit services provided by the Non Big Four auditors.

**Table 5: Descriptive Statistic of Audit Committee Status Variable**

| | | Frequency | Percentage | Valid Percentage | Cumulative Percentage |
|---|---|---|---|---|---|
| Valid | .00000 | 77 | 33.6 | 33.6 | 33.6 |
| | 1.00000 | 152 | 66.4 | 66.4 | 100.0 |
| | Total | 229 | 100.0 | 100.0 | |

The audit committee status variable is a dummy variable. Denotation 1 with the mean of 66.4% referes to the sample companies with the audit committee who have status. Denotation 0 with the mean of 33.6% referes to the sample companies with the audit committee that do not have status.

**Table 6: Normality Testing Before Treatment**

| | Kolmogorov-Smirnov | | | Shapiro-Wilk | | |
|---|---|---|---|---|---|---|
| | **Statistic** | **df** | **Sig.** | **Statistic** | **df** | **Sig.** |
| Unstandardized Residual | .183 | 584 | .000 | .729 | 584 | .000 |

The significance value of 0.000 indicates the data in the regression equation model has not been normally distributed. Therefore, a re-test of normality by eliminating 355 observations was needed.

**Table 7: Data Normality Re-Test**

| | Kolmogorov-Smirnov | | | Shapiro-Wilk | | |
|---|---|---|---|---|---|---|
| | **Statistic** | **df** | **Sig.** | **Statistic** | **df** | **Sig.** |
| Unstandardized Residual | .043 | 229 | .200* | .965 | 229 | .000 |

The normality re-test shows the value Kolmogorov-Smirnov is 0.2. It means that the data regression model has been normally distributed.

**Table 8: Heteroscedasticity Testing**

| Model | | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|---|---|---|---|---|---|---|
| | | **B** | **Std. Error** | **Beta** | | |
| 1 | (Constant) | .010 | .003 | | 3.368 | .001 |

| | | | | | | |
|---|---|---|---|---|---|---|
| | AT_Regulations | .001 | .001 | .070 | 1.049 | .296 |
| | AC_StatusxBackground | 7.59 | .001 | .004 | .060 | .952 |
| | Audit_Quality | -.002 | .001 | -.119 | -1.772 | .078 |
| | Ind_BC | .001 | .004 | .013 | .197 | .844 |
| | Ins_Own | .000 | .003 | .009 | .137 | .891 |

The significance values of all independent variables have exceeded the value of 0.05. It means there is no heteroscedasticity problems on the research regression model.

**Table 9: Multicollinearity Test**

| Model | | Unstandardized Coefficients | | Standardized Coefficients | T | Sig. | Collinearity Statistics | |
|---|---|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | | | Tolerance | VIF |
| 1 | (Constant) | -.048 | .005 | | -9.704 | .000 | | |
| | AT_Regulations | .003 | .002 | .109 | 1.786 | .075 | .992 | 1.008 |
| | AC_StatusxBackground | .006 | .002 | .174 | 2.838 | .005 | .989 | 1.011 |
| | Audit_Quality | .008 | .002 | .273 | 4.415 | .000 | .972 | 1.029 |
| | Ind_BC | -.002 | .006 | -.015 | -.244 | .807 | .964 | 1.038 |
| | Ins_Own | .020 | .006 | .216 | 3.521 | .001 | .983 | 1.018 |

All variables have tolerance values exceeding 0.1 and VIF values of less than 10. This result indicates that the regression equation is free from multicolinearity problem. This result also indicates that the independent variables are not correlated.

**Table 10: Autocorrelation Test**

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate | Durbin-Watson |
|---|---|---|---|---|---|
| 1 | .415[a] | .173 | .154 | .013047155 | 1.853 |

Durbin Watson's value of 1.853 is between dU value of 1.820 and 4-dU of 2.180. Therefore, no autocorrelation problem is indicated in the research regression model.

**Table 11: F Testing Result**

| Model | Sum of Squares | df | Mean Square | F | Sig. |
|---|---|---|---|---|---|
| Regression | .008 | 5 | .002 | 9.299 | .000[b] |
| Residual | .038 | 223 | .000 | | |
| Total | .046 | 228 | | | |

The significance value of 0.000 indicates that the variables of audit tenure regulations, the interaction between the status and background of the audit committee, audit quality, independence board of commissioners, and institutional ownership have an effect on the accruals quality.

**Table 12: Determinant Coefficient Test Result**

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|---|
| 1 | .415[a] | .173 | .154 | .013047155 |

The value of adjusted R square is 0.154, indicating that 15.4% of dependent variables are influenced by independent variables. Moreover, the rest equal to 84.6% of the dependent variables are influenced by other factors which are not included in the independent variables.

**Table 13: Hypotheses Testing Result**

| Variabel | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. (two way) | Sig. (α/2) (one way) |
|---|---|---|---|---|---|---|
| | B | Std. Error | Beta | | | |
| (Constant) | -.048 | .005 | | -9.704 | .000 | .0000 |
| AT_Regulations | .003 | .002 | .109 | 1.786 | .075 | .0375 |
| AC_StatusxBackground | .006 | .002 | .174 | 2.838 | .005 | .0025 |
| Audit_Quality | .008 | .002 | .273 | 4.415 | .000 | .0000 |
| Ind_BC | -.002 | .006 | -.015 | -.244 | .807 | .4035 |
| Ins_Own | .020 | .006 | .216 | 3.521 | .001 | .0005 |

All hypotheses testings in this study were one-way tests. Therefore the value of significance should be divided by two. Thus, the value of significance used to draw conclusions in this study was the value of Sig (α / 2). The significance value of variable AT_Regulations is 0.0375 < 0.050 and the regression coefficient is 0.003. It implies that the quality of the companies' financial statements were better after the issuance of the regulations regarding audit tenure in 2008. Empirically, the first hypothesis is accepted. This result is in line with Carey (2006) who found that the length of audit tenure will degrade the audit quality. This is also in line with Siregar et al. (2011) who found that longer audit tenure may affect the increase of the audit quality before reaching the optimal time period. However, after passing the optimal period, the audit quality will decrease as indicated by the increase of earnings management.

The significance value of AC_StatusxBackground is 0.0025 < 0.050 and the coefficient regression is 0.006. It implies that the interactions between status and background in accounting or finance of the audit committee have a positive effect on the financial statements. Empirically, the second hypothesis is accepted. This result is in line with Badolato *et al.* (2014) who found that the audit committee who had expertise and status can limit earning management measures within the companies.

The siginificance value of audit quality is 0.000 < 0.050 and the coefficient regression value is 0.008. It implies that the quality of the companies' financial statements using the Big Four's auditors is higher compared to the quality of the companies' financial statements which use the Non Big Four auditors. Empirically, the third hypothesis is accepted. This result is in line with the research conducted by Francis et al. (1999) who found that, although firms audited by the Big Six auditors had higher total accruals rates, they did have lower amount of discretionary accruals.

The significance value of board independence variable is of 0.4035 > 0.050. It indicates that the independence of the board of commissioners does not affect the quality of financial statements. Empirically, the fourth hypothesis is not accepted. This result is not in line with Sahlan (2010) who found that independence board of commissioners can reduce earnings managements through their roles in monitoring corporate management. According to al-Dhamari (2013), inconsistent research results might be caused by the independent board commissioners lacking in accounting or financial expertise and knowledge related to the companies themselves. Therefore, they could not detect whether or not errors or fraudulent exist in financial statements.

The significance value of institusional ownership variable is 0.0005 < 0.050 and the coefficient regression value is 0.020. It implies that institutional ownership affects the quality of financial statements. Empirically, the fifth hypothesis is accepted. This result is in line with the research conducted by Velury and Jenkins (2006) which indicated that institutional ownership positively affects earnings quality.

**CONCLUSION**

This study found that the audit tenure regulations, interactions between status and background of the audit committee, audit quality, and institutional ownership have a positive effect on the quality of financial statements. However, the independence of the board of commissioners has no effect on the quality of the financial statements.

This study contributes to investors and potential investors by providing an overview of companies which have good corporate governance. This overview would be beneficial to investors to choose a company to invest in. Furthermore, this study also contributes to the Ministry of Finance and the Financial Services Authority of Indonesia to continuously improve the quality of the regulatory and supervisory systems of companies listed on the Indonesia Stock Exchange. This study is also expected to contributes to the development of the regulations regarding public accountant services in Indonesia and the other countries. In addition, this study contributes to other countries to evaluate governance practices using corporate governance mechanisms in order to improve the quality of financial statement control.

## LIMITATION AND SUGGESTION

The limitation of this research was the study period to estimate the residual standard value of the cash flow change regression obtained from the sample companies three years earlier. This period of time was too short, so the sample may not be able to represent the company well. It is implied that a period of three years were not sufficient to reflect the accruals quality since the samples company commences operations.

Thus, for subsequent researcher may used a longer period of time to estimate the residual standard value of the operating cash flow change regression, so that the accruals quality results would have been more reflected the firms' accruals quality. In addition, for the subsequent researchers can adding several characteristics of companies, such as growth, sales volatility, cash flow volatility as additional variables are suggested to examine their effects on accruals quality.

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