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# The Moderating Effect of Benevolence on the influence of Corporate Governance on Audit Quality

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## ABSTRACT

In this study, we aim to examine the influence of corporate governance on the audit quality of financial report moderated by benevolence. The research data consisted of 320 observations from 80 public listed companies in the manufacturing industry from 2013-2016. The research model has been tested using a data pool, with statistics on Structural Equalization Modeling - Partial Least Square (SEM-PLS). The results of the study get empirical evidence that corporate governance has a positive effect on audit quality. While benevolence as an independent variable has a negative impact on audit quality, however, benevolence as a moderating variable strengthens the influence of corporate governance on audit quality. Likewise, SIZE as control variables have a positive effect on audit quality, but ROA no impact on audit quality and LEV have a negative impact on audit quality. The result of this study have implications for investors, company management and regulators, that good corporate governance is inseparable from the benevolence of management in managing the company as a way to improve audit quality, is something essential and needs attention from all parties.

Keywords: Corporate governance, audit quality, benevolence, size, leverage

## INTRODUCTION

The number of companies that fail is not just because of competition, but because poor of corporate governance practices and audit quality, corporate governance and audit quality are essential for benevolence if we want to ensure business sustainability is maintained. Because corporate governance and good audit quality are crucial factors in the sustainability of the company's operations and maintaining trust from the investor community.

Rahman & Bremer (2016) states that good corporate governance will produce accurate and trusted financial reports, while bad governance usually followed by the practice of corporate scandals, fraud and fraud that will deliver financial reports which are inaccurate and potentially can cause loss of trust in financial statements. Similarly, the role of external auditors, users of financial statements view the task of external auditors as not only seeing compliance with regulations and audit standards, but are expected to be able to detect and report fraud and fraud that can cause loss of trust in financial statements (Lee, Ali, & Gloeck, 2008). Auditors are also expected to be able to carry out their duties professionally to be able to enforce the law when examining their clients' financial statements (Ang & Lim, 2008). Because according to Imhoff Jr (2003), financial reports that have integrity and trustworthiness cannot be separated and are always closely related to corporate governance and auditing.

Also, according to Eilifsen & Willekens (2008) good corporate governance and external audit of financial statements, it should lead to reasonable guarantees about financial statements as the definitive source that can be used by stakeholders and shareholders outside the company. For that, the practice of good corporate governance and audit quality in public companies is essential because public companies should be trusted. However, current corporate governance practices and audit quality still hold a big question mark for users of financial statements, whether corporate governance practices can affect audit quality to be more qualified and implemented based on benevolence from company management and auditors. Due, there are still many cases of corporate financial scandals in the past in two decades that have been revealed to the public and continue to this day, which is the motivation for this research.

This research focuses on the effects of corporate governance on audit quality moderated by benevolence because according to the expectations of researchers' audit quality is inseparable and is always related to the practice of corporate governance and good intentions from company management and auditors who carry out audit functions.

## LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

### 2.1. Corporate governance and audit quality

Cadbury (1993) describes that corporate governance as a structure that directs and regulates business to reach a balance between the authority needed by the business, ensuring continuity, presence and responsibility to shareholders and stakeholders linked to controlling the jurisdiction of the owner, manager, shareholder and other stakeholders.

Control and ownership are always associated with the agency issue, along with information between management and absentee owners, creating demand for external audit (Lin & Hwang, 2010). In traditionally, DeAngelo (1981) defined that audit quality as the joint probability of discovering material misrepresentations and reporting them when they exist that an existing problem is discovered and reported by the auditors.

Corporate governance in academic studies of auditing is usually considered solely in its relation to auditor quality, i.e. Beisland, Mersland, & Strøm (2015) focused on audit fee and the presence of internal auditors; Chang, Chi, Hwang, & Shiue (2015) going concern opinion; Chu, Mathieu, & Mbagwu (2009) auditor's industrial specialization; Ejeagbasi, Nweze, Ezeh, & Nze (2015) Auditor Size and Lin & Hwang (2010) Auditor tenure, auditor size, audit fee, and auditor specialization.

The relationship between corporate governance and audit quality was investigated by a large and growing body of literature (Beisland et al., 2015; Carcello, Hermanson, Neal, & Riley, 2010; Chang et al., 2015; Chu et al., 2009; Ejeagbasi et al., 2015; H. Y. Lee & Jahng, 2008; Lin & Hwang, 2010; Park, Shin, & Suh, 2013; Velury, Reisch, & O'reilly, 2003; Yeoh & Jubb, 2001). Previous studies have shown that firms with stronger corporate governance structures require improved quality of audit (Carcello et al., 2010; Riguen, Kachouri & Jarboui, 2018) and have reported financial trust (Rahman & Bremer, 2016).

In this context, the impact of corporate governance and quality of audit on microfinance sectors in the 70 developed countries was examined in research undertaken by Beisland et al. (2015). The empirical outcome discovered a favourable relationship between corporate governance and quality of audit. Similar study conducted by Makni, Kolsi, & Affes (2012) using 29 Tunisian companies as an observation sample during 2005-2009, claims that corporate governance

measured by duality boards has a beneficial impact on audit quality, and Gul & Leung (2004) also reported a favourable connection between corporate governance measured by duality boards and audit quality (proxy by audit fee). In the same research,
Beasley & Petroni, 2001 undertook the same study; Carcello et al., (2010); Lennox, (2005) states that corporate governance through director from external favours the efficiency of the supervisory function of the board and influences board choices in selecting a better quality of audit.
Overall, some proof appears to suggest that corporate governance has a positive influence on audit qualities. Our hypothesis is, therefore, as follows:
**H1:** *There is a positive correlation between corporate governance on audit quality.*

### 2.2. Benevolence and audit quality.

Benevolence (goodwill), in the context of this study defined as the auditor's ability to carry out his duties by professionally and responsibly with upholding integrity, based on good intentions that can provide mutual satisfaction between the auditor and auditee without sacrificing the public interest. Auditors and auditees not only pursue the interests of big business profits but can realise satisfaction and public trust because benevolence is a spirit inherent in corporate governance and auditors to produce quality and reliable financial reports. The numbers and information contained in the financial statements are managed and made in good faith so that they can provide benefits and benefits to others, and protect the interests of users of financial statement information. Benevolence, according to Kim, Ferrin, & Rao (2003), includes attention, empathy, confidence and acceptability.
Professional auditor in public accountant firms must meet professional standards in working with their client. But may also face pressure from both their clients and firms when making ethical decisions (Hageman & Fisher, 2016). It has long been suspected that the financial interests auditors have in their clients can adversely affect their independence (AICPA, 1978; Mautz & Sharaf, 1961). There is a tendency, the auditor's dependence on the audited party, in theory, has a negative impact on auditor quality (DeAngelo 1981) and has a negative effect on virtue and ethics that the auditor must uphold as an independent party. All overall, the findings of the Chen, Sun, & Wu (2010)-study show that auditors in China are more likely to compromise towards audit quality for clients economically important when an institution protects weak investors. Hence, DeAngelo (1981) stated that incumbent auditors not expected to be entirely independent of their client, as the latter can impose a real cost on the former by terminating the bilateral relationship. Furthermore, Chen et al., (2010) stated that it is *ceteris paribus* the more significant the client in auditor’s portfolio, the stronger should be the incentive that the auditor has to retain that client. And thus possibility compromise audit quality and unethical behaviour are more likely when the firms’ ethical climate emphasises individual decision-making as guided by employees’ sense of personal morality (Hageman & Fisher, 2016) and tend to ignore benevolence on their professionalism. Hence our hypothesis as follows:
**H2**. *There is a negative correlation between benevolence and audit quality.*

### 2.3. The moderating effect of benevolence on the impact of corporate governance on audit quality.

Chen et al., (2010), studied regarding the relationships among economic importance, institutional improvements and audit quality in the context of China, in the level of office and individual. The empirical result shows that at the individual level modified audit opinion (MAO) negatively correlated with client necessary. Otherwise, when the institutional environment becomes more investor-friendly, the propensity to issue MAO is positively associated with client importance. The client importance measured at the office level is also negatively related to the propensity for MAO without controlling for the auditor-level client important. The result of this study that (1) Institutional improvements encourage auditors to prioritise the compromising performance over the financial advantages acquired by the significant client; and (2) the effect of client significance on audit quality choices seem to differ at the auditor level and the office level.

In addition, a study conducted by Hageman & Fisher (2016) on the influence of client attributes and organisational climate on tax (including) audit professionals on the relationship between benevolence and quality of service in public accounting firms. This study found that the client service climates were stronger among ethical environments that emphasised the following rules and codes of law as those with an emphasis on benevolence or doing what is best for others. These findings suggest that a positive service climate, where auditors perceive that the firm's practice, procedure and behaviour than expected, supported, and rewarded contribute toward service excellence (Schneider, White, & Paul, 1998).

In their study, Aschauer, Fink, Moro, van Bakel-Auer, & Warming-Rasmussen (2016) the relationship between auditors' identification-based trust in client firms' manager (CEOs/CFOs) and their perceptions of auditors' professional scepticism data collected from 233 auditor-client dyads in Germany. The study conclusion is auditors' identification-based trust is positively associated with their clients' perception of the professional scepticism.

The other study conducted by Garrett, Hoitash, & Prawitt (2014) the relationship between trust with attributes ability, integrity and benevolence (following Mayer, Davis, & Schoorman, 1995 models) on financial reporting quality (with attributed: accrual quality, misstatements and internal control). The study concluded that trust (ability, integrity and benevolence) positively associated with financial reporting quality, especially to internal control as parts of audit quality.

Ogbeibu, Senadjki, & Gaskin (2018) conducted a study on the relationship between the impact of organisational culture on employee creativity of Nigerian manufacturing industries. The empirical results show that top management leaders' benevolence is moderating positive and significant effect on the impact of organisational culture and employee creativity. Hence our hypothesis as follows:

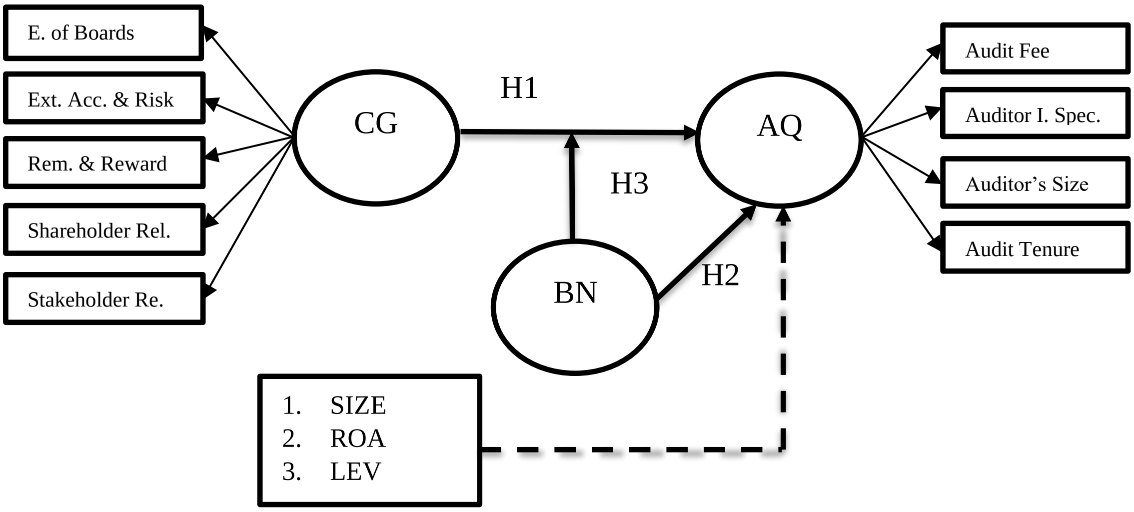
**H3:** *The benevolence strengthens of corporate governance correlation on audit quality.*

## RESEARCH METHOD

### RESEARCH METHOD AND SAMPLE SELECTION

This study focused on exploring the influence of corporate governance composite of 45 items covering a broad category of dimension, i.e. 1). Effectiveness of boards; 2). accountability of external & risk; 3). Remuneration and rewards; 4). Shareholder relations and 5). Stakeholder relations (from now on referred to as EARSS) on the audit quality measured by four attributed, i.e. 1). Audit fee, 2). Audit industrial specialist, 3). Auditor size and 4) audit tenure (from now on referred to as FISST) moderated by benevolence on manufacture industries public listed company in Indonesia.

Figure 1: Research Framework




### 3.2. Research Method

In order to test the hypotheses and the empirical analysis, a regression model modified from the research of Husnin et al., (2016) and Lin & Liu (2009) to estimate the relationship based on the following research model

$$\mathbf{CG = \beta0+\beta1AQ+\beta2BN+\beta3(AQ*BN)+\beta4SIZE+\beta5ROA+\beta6LEV+\varepsilon}$$

Notes: CG = Corporate Governance; AQ = Audit Quality; BN = Benevolence; SIZE = Company Size; ROA = Return on Asset; LEV = Leverage

### 3.3. Measurement of Variables

Research variables, both dependent, independent and control variables are measured from each company "*i*" in the year "*t*" during the observation period as shown in exhibit 2:

**Table 1: Statutory Variables Measurements**

| Variables | Symbols | Measures | Authors |
|---|---|---|---|
| **Audit Quality** | AQ | Audit quality measured by four audit quality attributes (FISST):<br>1. Audit fee: Ln of audit fees per year paid by the company to the auditors.<br>2. Auditor's industrial specialist: Percentage of total auditor market share by industry.<br>3. Auditor size: Total number of auditor's client<br>4. Audit tenure: The total length of auditor's tenure with the company. | Chang et al., 2015; Chu et al., 2009; Park et al., 2013; Riguen et al., 2018; Sailendra, Murwaningsari, & Mayangsari, 2019. |
| **Corporate Governance** | CG | Independent variables: Corporate governance index composite of forty-five items, covering five broad categories of dimensions: effectiveness of boards; Accountability of external & risk; Remuneration & Rewards; Shareholder relations and Stakeholder relations (EARSS). | IOD, 2017; Riguen et al., 2018; Sailendra, 2019. |

| | | | |
|---|---|---|---|
| **Benevolence** | BN | Moderating variables: Number of attributes for the company *i* divided by total (seven attributes) | Ogbeibu et al., 2018; Sailendra, 2019. |
| **Size** | SIZE | Ln of the total asset at the end of year | Garrett et al., 2014; Riguen et al., 2018; Sailendra et al., 2019. |
| **Return on Asset** | ROA | The ratio of earnings before tax divided by total assets. | Garrett et al., 2014; Riguen et al., 2018; Sailendra et al., 2019. |
| **Leverage** | LEV | The Total ratio debt divided by total assets. | Garrett et al., 2014; Riguen et al., 2018; Sailendra et al., 2019. |

### 3.1. Data Collection and sample size

Research sample data are manufacturing companies listed on the Indonesia Stock Exchange (IDX) originally from 146 companies. The data's taken from the database of the Indonesia Stock Exchange (IDX) and the Accounting Professional Development Center (P2PK) of the Ministry of Finance of the Republic of Indonesia. After selection based on predetermined criteria, some companies did not disclose their audit fee data and also did not meet corporate governance indicators; there are 66 companies dropped from the research sample. So that the final data used as samples for this study were 80 companies or 320 years-observation.

## RESULTS AND DISCUSSION

### 4.1. Descriptive Statistics

**Table 2: Descriptive Statistics**

| Variable | | N | Min | Max | Mean | SD |
|---|---|---|---|---|---|---|
| **Audit Quality (FISST)** | Audit Fee | 320 | 7.81 | 10.60 | 25.78 | 15.24 |
| | Auditor's industrial specialist | 320 | 1.00 | 2.00 | 1.33 | 0.47 |
| | Auditor's size | 320 | 1.26 | 3.34 | 2.93 | 0.32 |
| | Auditor's tenure | 320 | 1.00 | 7.00 | 2.93 | 1.62 |
| **Corporate Governance (EARSS)** | Effectiveness of Boards | 320 | 2.22 | 20.00 | 11.49 | 3.34 |
| | Accountability of External & risk | 320 | 6.67 | 17.78 | 12.89 | 2.47 |
| | Remuneration and Rewards | 320 | 0.00 | 17.78 | 4.66 | 5.43 |
| | Shareholder relation | 320 | 4.44 | 11.11 | 6.17 | 1.81 |
| | Stakeholder relation | 320 | 0.00 | 13.13 | 6.92 | 3.94 |
| **Variabel moderating** | Benevolence | 320 | 0.00 | 14.29 | 6.64 | 2.66 |
| **Variabel control** | Company Size (SIZE) | 320 | 10.99 | 14.42 | 12.42 | 0.70 |
| | Return on asset (ROA) | 320 | -0.21 | 0.66 | 0.05 | 0.09 |
| | Leverage (LEV) | 320 | 0.04 | 1.25 | 0.50 | 0.22 |

Source: SPSS statistical Ver.23 output, processing by authors

### 4.2. Analysis and results

The results of the study and statistical testing of the relationship between variables are described in Table no. 3.

Table 3: Statistical Results

| | Original Sample (O) | Sample Mean (M) | Standard Deviation | T Statistic (│O/STDE│) | P Values |
|---|---|---|---|---|---|
| **CG → AQ** | 0.198 | 0.206 | 0.059 | 3.324 | 0.000*** |
| **BN → AQ** | -0.083 | -0.087 | 0.050 | 1.675 | 0.047** |
| **Z1 → AQ** | 0.081 | 0.077 | 0.041 | 1.968 | 0.025** |
| **SIZE → AQ** | 0.619 | 0.617 | 0.046 | 13.362 | 0.000*** |
| **ROA → AQ** | -0.014 | -0.016 | 0.040 | 0.355 | 0.361 |
| **LEV → AQ** | -0.117 | -0.118 | 0.041 | 2.873 | 0.002** |

Source: Smart-PLS 3.0 output, processing by authors
The symbols: ***, **, * denote significance level at the 1%, 5% and 10%, respectively.
Notes: CG = corporate governance; AQ = audit quality; BN = benevolence; Z1 = moderating effect (CG*BN); SIZE = company size; ROA = return on asset and LEV = leverage.

As presented in Table no. 3, the results show that Corporate Governance (CG) as defined by effectiveness of boards, accountability of external and risk, remuneration and reward, shareholder relation and stakeholder relation (EARSS) has positive impact on Audit Quality (AQ) as defined by audit fee, auditor industrial specialist, auditor size and audit tenure (FISST) indicated by the p-value 0,000. The conclusion that good corporate governance practice has a positive relationship on audit quality, it is supported the previous research by  (Beisland et al., 2015; Collier & Gregory, 1996; Gul & Leung, 2004; Makni et al., 2012). And also this empirical research found in line by a previous empirical study by Carcello et al., 2010; Riguen et al., 2018 stated that good corporate governance structure demands better audit quality and more trusted financial report (Rahman & Bremer, 2016) and it is reflecting of audit quality of financial report.

Benevolence has a negative impact on audit quality as shown in the Table No.3 with statistical p-value 0.047 and negative sign in the original sample (O) -0.083 and in the sample mean (M) value -0.087. This evidence indicates that in stand-alone benevolence cannot playing a vital role to influence audit quality without supported by good corporate governance practice. This empirical evidence supported statements stated by DeAngelo (1981) that incumbent auditor is not always expected to be entirely independent of their client, especially on the more significant the client in auditor’s portfolio. The stringer should be incentive that the auditors have to retain that client and thus possibility compromise audit quality (Chen et al., 2010), then unethical behaviour is more likely when the firms’ ethical climate emphasis by individual decision-making as guided by employee’s sense of personal morality (Hageman & Fisher, 2016). Due, it is indicated by a negative relationship between benevolence and audit quality in this study.

Otherwise, corporate governance moderated by benevolence strengthening the audit quality. That is means that good organisational governance structure and practice will more strengthen audit quality moderated by benevolence with pleasant ethical climate and environment in organisation culture (Chen et al., 2010; Hageman & Fisher, 2016). Better corporate governance structure and practice with environmental of organizational ethical culture Ogbeibu et al., 2018; and auditors’ identification-based trust is positively associate by auditors’ client perceptions of their professional scepticism (Aschauer et al., 2016), and benevolence as a moderating variable combine with good governance structure and practice will positive significant on audit quality.

The control variables, company size (SIZE) is a positive correlation with audit quality (AQ); which indicate that bigger company size will provide more resources, technology, expertise and capability they have to support output quality of work prepared by management to verified by external auditors and it implies on audit quality. Return of asset (ROA) no effect on audit quality but in the original sample (O) statistic value is a negative sign, that indicates that ROA is potential have a negative impact on audit quality due agency problem if any compromise between auditee and auditor on that. And then, leverage (DAR) negatively correlated with audit quality; it is indicating that more high leverage owing by company, that the health of financial ability. And it is a signal of distress and bankruptcy always perception by the public, then as a potential area to compromised between auditee and auditor for company management interest, due negative relation between leverage and audit quality on this study.

## CONCLUSIONS

This study empirically examines the corporate governance influence through six dimensions, i.e. effectiveness of boards, accountability of external and risk, remuneration and rewards, shareholder relations and stakeholder relations (EARSS) on audit quality attribute by audit fees, auditor industrial specialist, auditor size and audit tenure (FISST). Total observation for this study is 320 years-observation from 80 public listed manufacturing companies on the Indonesian Stock Exchange (IDX) from 2013-2016.
The results of our study provide empirical research that corporate governance positively correlation on audit quality, which can be explained that good corporate governance structure positive and demand better audit quality (Beisland et al., 2015; Carcello et al., 2010; Collier & Gregory, 1996; Gul & Leung, 2004; Makni et al., 2012; Riguen et al., 2018) and more trusted financial report (Rahman & Bremer, 2016). Benevolence is a negative correlation on audit quality, this explains that in stand-alone benevolence can be compromised by auditee and auditor for interest of management and auditors if supported by an ethical behaviour of corporate culture with managerial benevolence own sense of personal morality (Chen et al., 2010; DeAngelo, 1981; Hageman & Fisher, 2016). And as moderating variable benevolence strengthening the correlation between corporate governance and audit quality, this can be explained that good corporate governance structure and practice and benevolence with proper climate emphasis of organizational culture and good ethical personal morality is positive significant on audit quality. For this reason, especially for regulator and company management to encourage good corporate governance structure and practice with strengthening environmental, ethical corporate culture as a way to improve audit quality and trusted from investor and public.
Due to the small size data sample used and short of time horizons, the results of this study cannot be generalised for all industry types. In the future research needs to include other independent variables such as intellectual capital, the structure of capital, social environment, corporate culture and also need to expand of auditor quality attributes such as audit opinion, going concern, workload pressure, partner tenure to enrichment and more comprehensive of evidence in the future. Base on previous research, the result of this study contribute to the literature and could constitute a reference for future research. Notably for benevolence variable as a new paradigm to study corporate governance and audit quality correlated with trusted and quality of the financial report as our significant contribution for future research references, especially in the emerging economic country, such as Indonesia.

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