

## The Influence of Leverage, Profit Quality, KAP's Reputation on Audit Quality in Manufacturing Companies Listed on the Indonesian Stock Exchange 2019-2021

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DOI 10.56201/ijebm.v9.no8.2023.pg70.81

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### Abstract

*This study aims to empirically prove the effect of leverage, profit quality, KAP's reputation on audit quality in manufacturing companies listed on the Indonesia Stock Exchange in 2019-2021. The method of this research is to use panel data regression analysis which is used to determine the effect of the independent variable and the dependent variable jointly and partially over a certain period of time. In this study the t test and f test were used to test the influence of each variable leverage, profit quality, KAP reputation together on audit quality. The population of this research is 171 companies and the sample used in this research is 83 manufacturing companies listed on the Indonesian Stock Exchange in 2019-2021. This data collection method uses secondary data and is processed by EVIEWS 12. From the results of the t test and f test it is known that the variable leverage, profit quality and KAP reputation have a significant effect on audit quality.*

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**Key Words:** Leverage, Profit Quality, KAP Reputation, Audit Quality

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### Introduction

Audit quality is an important factor that will influence investors decisions in considering and making decisions regarding their capital investment in a company. Audit quality describes how compliant an audit result is with applicable audit standards, meaning that the higher the quality of the audit results produced by the auditor, the more it can influence investors' interest and confidence in whether or not to invest in the company. Triggers for poor quality audits can come from various factors such as the auditor's own mistakes or caused by unexpected things such as the Covid-19 pandemic which affects the auditors' performance. Improving the internal control system is the urgency of this research. It is hoped that with this research, auditors will be able to minimize the risk of errors and can also identify fraud that occurs in the company's financial reports to the maximum extent.

Researchers decided to choose manufacturing companies as the object of this research because financial transactions in manufacturing companies are more complex, creating challenges in terms of controlling and recording appropriate financial reports. This can trigger errors or fraud in the company's financial reports. Therefore, this research can help auditors understand the things that must be paid attention to in order to minimize the risk of errors and fraud in the company's financial reports. Researchers chose to examine manufacturing companies in that year because in that year, the country was facing the Corona Virus which could affect economic stability and trigger audit quality.

Based on a review of previous research, it appears that there are inconsistencies in research results or research gaps, so the researcher wants to re-examine these variables with the title "The Influence of Leverage, Profit Quality, KAP's Reputation on Audit Quality with Empirical Studies in Companies Manufacturers Listed on the Indonesian Stock Exchange 2019-2021."

### **Objectives of the study**

The objectives of the study is to:

- i. Empirically proving the respective influence of Leverage, Profit Quality and KAP Reputation on the Audit Quality of manufacturing companies listed on the IDX in 2019-2021

### **Research Questions**

From the objectives of the studies, the following research questions were raised to guide the studies:

- i. Does leverage affect the audit quality of manufacturing companies listed on the IDX in 2019-2021?
- ii. Does Profit Quality influence the audit quality of manufacturing companies listed on the IDX in 2019-2021?
- iii. Does KAP's reputation affect the audit quality of manufacturing companies listed on the IDX in 2019-2021?

### **Research Hypotheses**

To achieve the objectives of this study, the following hypotheses were formulated as a guide to the study.

H1: Leverage has a significant effect on Audit Quality.

H2: Profit Quality has a significant effect on Audit Quality.

H3: KAP reputation has a significant effect on Audit Quality.

### **Conceptual Review**

Audit quality is the auditor's ability to be independent, honest and thorough in carrying out the audit process in accordance with applicable standards so that it can be ensured that no misstatements or fraud occurs in the financial reports. In producing audit quality, auditors must have two dimensions, namely competent and independent. Auditors must be able to find and reveal violations and provide an honest assessment of the financial reports that have been examined. (Ardianingsih, 2021: 22-24).

#### **Leverage:**

According to Brealey et al (2016), Leverage is the use of borrowed funds or capital to increase profits in a business and functions to develop the company's business or operations. Auditors must comply with applicable regulations and codes of ethics when examining company financial reports. One of them is paying attention to the company's leverage. Leverage is considered important and influences audit quality because the higher the leverage ratio value, the higher the risk faced by investors.

The decision to use high debt can increase the value of the company so auditors must carefully pay attention to one of these factors, because companies tend to commit fraud in reducing debt or increasing income in order to show a good image of the company to investors (Felicia & Sofia, 2021: 139)

#### **Profit Quality:**

According to Wahlen et al (2018), profit quality is a measure of the extent to which a company's profit report provides relevant and reliable information in decision making. Profits must be of high quality because profits are one of the determinants of a company's success and one of the references for investors in making decisions. Auditors must obey and comply with existing rules and codes of ethics, so that auditors can be independent and honest in ensuring whether the profit information presented in the financial statements is presented fairly and with quality, because this can affect the quality of the audit as well as influence the decisions of stakeholders. interest. (Nada & Erinos, 2020).

#### **KAP reputation:**

KAP reputation is a perception formed by related parties, including clients, investors and other stakeholders regarding the reliability, integrity and competence of auditors in conducting audits professionally (Gramling & Rittenberg, 2018). Financial reports must be audited by a Public Accounting Firm (KAP) to ensure that the financial statements presented by the company are reasonable. (Yudhi Herliansyah, 2023). Auditors are required to comply with applicable

professional rules and ethics, such as being independent, honest, thorough and able to take responsibility for the results of audits that have been completed. With a good KAP reputation, the reputation of an auditor who works at that KAP will also have a good reputation. Auditor reputation is an auditor's responsibility to maintain the good name and public trust in KAP by maintaining audit quality (Agung, 2023).

## **Theoretical Review**

Compliance theory is a theory that provides an explanation of the conditions of a person's compliance with applicable standards or regulations (Stanley Milgram, 1963). Compliance theory and audit quality are directly proportional and interrelated. This means that if the auditor complies with the applicable professional rules, the audit results produced by the auditor will be of high quality. Researchers chose to use compliance theory because the benefit of this research is to improve the auditor's internal control system.

Audit results or reports prepared and signed by a public accountant must be independent and contain statements and opinions that have been tested and in accordance with existing criteria. With the existence of these rules and related to compliance theory, of course it is indirectly able to force auditors to comply with applicable rules and make auditors become independent individuals and comply with the rules that have been set so that they are able to produce quality audit results that reflect the condition of the company and become useful information. beneficial to stakeholders. Audit quality is how much the quality produced by the auditor conforms to the applicable audit standards or in other words it can be said to be a possibility that the auditor finds violations that do not reflect the quality of the information and then reports material misstatements in the financial statements. Audits must be free from bias and dishonesty and must contain complete information. (Wiwik Utami, 2019).

## **Empirical Reviews**

There are many studies that have conducted research on the relationship between the influence of leverage, profit quality and KAP reputation on audit quality.

Based on research previously conducted by (Wulandari & Handojo, 2018) and supported by Alawaqleh et al (2021), they stated that leverage has a significant effect on audit quality, meaning that high or low leverage values can affect audit quality, so the independence of an auditor is also necessary. noticed. This is because leverage directly affects audit quality because leverage is an opening for companies to manipulate their financial reports to make them look good in the eyes of investors. However, auditors are also required to be experts and responsible for identifying and overcoming the risk of fraud or manipulation by using appropriate audit procedures.

Based on previous research conducted by Alaqrabawi (2023) and supported by Darwin Marasi (2019), it is stated that profit quality has been proven to have a positive effect on audit quality. Profit quality has a significant effect on audit quality because good profit quality and the existence of strong supporting evidence indicate that the company's internal control is running effectively.

If the company has a good internal control system, the risk of fraud or theft will be lower. So this supports auditors to produce quality audits.

Based on previous research conducted by Alsughayer (2021) and supported by Effendi & Ulhaq (2021), it is clear that KAP reputation has a significant effect on audit quality. Because the better the reputation of the KAP, it will create client trust in the services provided by the KAP and a quality audit will be created (Agung, 2023).

## Methodology

Manufacturing company financial reports from 2019 to 2021 were used for this research. All data comes from the Indonesian Stock Exchange (BEI). The research variable consists of :

Audit Quality = ROA (Total Revenue / Total Assets)

Leverage = DER (Total Debt / Total Equity)

Profit Quality = Operating Cash Flow / Net Income

KAP reputation is using a dummy variable. Companies that are audited by KAPs that are affiliated with the big four KAPs are given the number 1. And companies that are audited by KAPs that are not affiliated with the big four will get the number 0.

The data analysis method used in this research is a quantitative description method which can be carried out using descriptive statistics. The data that has been obtained will be further managed using the Eviews program tools so that it can maximize the description of the research object and then conclusions will be drawn on the results. Then Panel Data Regression Analysis was carried out. Panel data regression analysis is a statistical method used to model the relationship between dependent variables and independent variables using data that includes individual units observed over a certain period of time. Panel data includes a cross-time dimension (time series) and a cross-latitudinal dimension (cross-sectional), making it possible to examine individual effects and time effects in the relationship. This panel data regression analysis is used to analyze how much influence the independent variable has on the dependent variable using the equation model:

$$Y = \alpha + \beta_1 L + \beta_2 KL + \beta_3 RK + \beta_4 KA + \beta_5 (L * ZKA) + \beta_6 (KL * ZKA) + \beta_7 (RK * ZKA) + \varepsilon$$

Information:

Y: Audit Quality

$\alpha$  : constant

$\beta_1$ -  $\beta_7$ : regression coefficient

L: Leverage

KL : Profit Quality

RK : KAP's reputation

KA : Audit Committee

(L\*ZKA): Interaction between Leverage and the Audit Committee.

(KL\*ZKA): Interaction between Profit Quality and Audit Committee  
 (RK\*ZKA): Interaction between KAP Reputation and Audit Committee  
 $\varepsilon$  : residual disturbance factor (disturbance error)

## Results and Discussion

**Table 1: Descriptive Statistics**

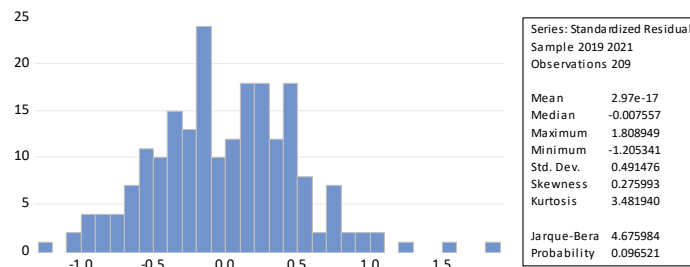
|              | LEV_X1    | KL_X2     | RK_X3    | KA_Y     |
|--------------|-----------|-----------|----------|----------|
| Mean         | 0.872386  | 2.347867  | 0.305221 | 2.863454 |
| Median       | 0.703550  | 1.370000  | 0.000000 | 3.000000 |
| Maximum      | 10.28053  | 143.6991  | 1.000000 | 4.000000 |
| Minimum      | -2.127341 | -116.6635 | 0.000000 | 0.000000 |
| Std. Dev.    | 0.988542  | 14.16609  | 0.461428 | 0.699532 |
| Observations | 249       | 249       | 249      | 249      |

**Source:** Author's Compilation from Eviews 12, 2023 Output

The results in Table 1 reveal that the amount of data obtained has 249 samples consisting of 83 companies listed on the Indonesia Stock Exchange for 3 years, namely 2019-2021.

- a) The minimum value of the Leverage variable (X1) is -2.13, indicating that the company's total equity is in a minus position and this indicates that the company's financial condition is vulnerable because its equity alone is not enough to cover its debt. The maximum value is 10.28 because the total debt held by the company is greater than the total equity owned.
- b) The minimum value of the Profit Quality variable (X2) is -116.66, indicating that the cash flow value is in a minus position, which means that the company may face financial difficulties and the risk of default. And the maximum value of 143.70 indicates that the cash flow value is greater than net income, which means the company is able to pay the company's financial obligations.
- c) The minimum value of the KAP Reputation variable (X3) is 0, indicating that the KAP chosen by the company is not affiliated with the big 4. And the maximum value of 1 indicates that the KAP chosen by the company is affiliated with the big 4.

**Table 2: Normality Test**



**Source:** Author's Compilation from Eviews 12, 2023 Output

The histogram normality test results in the table above show a significant probability level of 0.096. Because the value (Asymp.sig) is significant 0.05, it can be concluded that the residual data in this regression model is normally distributed.

**Table 3: Multikolinearity Test**

| Variable | Coefficient Variance | Uncentered VIF | Centered VIF |
|----------|----------------------|----------------|--------------|
| C        | 0.050241             | 23.38517       | NA           |
| LEV_X1   | 0.003768             | 2.545501       | 1.020409     |
| KL_X2    | 0.000110             | 1.214403       | 1.037006     |
| RK_X3    | 0.008658             | 2.072580       | 1.006682     |
| KOMIT_Z  | 0.005215             | 21.36154       | 1.013693     |

**Source:** Author's Compilation from Eviews 12, 2023 Output

Based on the multicollinearity test results presented in the table above, it can be seen that the Centered VIF value for all independent variables is less than 10, so it can be concluded that this regression model is free or does not experience multicollinearity problems.

**Table 4: Auto Correlation Test**

|                    |           |                       |          |
|--------------------|-----------|-----------------------|----------|
| R-squared          | 0.115598  | Mean dependent var    | 0.012780 |
| Adjusted R-squared | 0.087522  | S.D. dependent var    | 0.338719 |
| S.E. of regression | 0.323557  | Akaike info criterion | 0.618537 |
| Sum squared resid  | 13.19082  | Schwarz criterion     | 0.728277 |
| Log likelihood     | -35.51417 | Hannan-Quinn criter.  | 0.663129 |
| F-statistic        | 4.117279  | Durbin-Watson stat    | 2.108168 |
| Prob(F-statistic)  | 0.003607  |                       |          |

**Source:** Author's Compilation from Eviews 12, 2023 Output

Based on the table data above, it can be seen that the Watson Durbin value is 2.1081 and this will be compared with the Watson Durbin table values, namely DL (1.74513) and DU (1.80305). Based on the Durbin Watson table which was obtained with a significance value of 0.05 with a number of variables of 4 (K=4) and it is known that the number of samples after outliers is (n) 210, then the DW table value is 2.1081. The decision is based on the condition  $du < dw < 4-du$  and the value obtained is  $1.80305 < 2.1081 < 2.1969$ . Thus it can be concluded that the data used does not experience autocorrelation.

**Table 5: Heteroskedasticity Test**

Heteroskedasticity Test: Glejser  
 Null hypothesis: Homoskedasticity

| F-statistic         | 2.028100 | Prob. F(4,203)      | 0.0918 |
|---------------------|----------|---------------------|--------|
| Obs*R-squared       | 7.992800 | Prob. Chi-Square(4) | 0.0918 |
| Scaled explained SS | 8.064511 | Prob. Chi-Square(4) | 0.0892 |

**Source:** Author’s Compilation from Eviews 12, 2023 Output

Based on the results of the heteroscedasticity test in the table above, it can be seen that the probability chi-square value in Obs\*R-Squared is  $0.0918 > 0.05$ . So it can be concluded that there are no symptoms of heteroscedasticity in the regression model tested.

**Table 6: Regression Model Estimation**

**6.1 Chow Test**

Redundant Fixed Effects Tests  
 Equation: Untitled  
 Test cross-section fixed effects

| Effects Test             | Statistic  | d.f.     | Prob.  |
|--------------------------|------------|----------|--------|
| Cross-section F          | 16.683671  | (78,127) | 0.0000 |
| Cross-section Chi-square | 508.215022 | 78       | 0.0000 |

**Source:** Author’s Compilation from Eviews 12, 2023 Output

Based on the results of the Chow test in the table above, it shows that the probability cross section chi square value is smaller than the significance value, namely  $0.0000 < 0.05$ . Thus,  $H_0$  is rejected and  $H_1$  is accepted, so the appropriate temporary regression model to be used in this research is the fixed effect model (FEM). Next, to select the best model between the fixed effect model and the random effect model, the Hausmant test will be carried out.

**6.2 Haustmant Test**

Correlated Random Effects - Hausman Test  
 Equation: Untitled  
 Test cross-section random effects

| Test Summary         | Chi-Sq. Statistic | Chi-Sq. d.f. | Prob.  |
|----------------------|-------------------|--------------|--------|
| Cross-section random | 29.833619         | 4            | 0.0000 |

**Source:** Author’s Compilation from Eviews 12, 2023 Output



Based on the results of the Hausmant test in the table above, it shows that the random cross section probability value is smaller than the significance value, namely  $0.0000 < 0.05$ . Thus,  $H_0$  is rejected and  $H_1$  is accepted, so that the appropriate and best regression model to use in this research is the fixed effect model (FEM).

**Table 7: Coefficient Determination Test ( $R^2$ )**

| Cross-section fixed (dummy variables) |          |                       |          |
|---------------------------------------|----------|-----------------------|----------|
| R-squared                             | 0.929552 | Mean dependent var    | 1.042751 |
| Adjusted R-squared                    | 0.884066 | S.D. dependent var    | 0.711395 |
| S.E. of regression                    | 0.242223 | Akaike info criterion | 0.289640 |
| Sum squared resid                     | 7.451346 | Schwarz criterion     | 1.612545 |
| Log likelihood                        | 52.58776 | Hannan-Quinn criter.  | 0.824442 |
| F-statistic                           | 20.43603 | Durbin-Watson stat    | 2.917239 |
| Prob(F-statistic)                     | 0.000000 |                       |          |

**Source:** Author's Compilation from Eviews 12, 2023 Output

Based on the table above, the R-Square value is 0.9295. This value means that the variables leverage, profit quality, KAP reputation and audit committee are able to influence audit quality by 92.95%, while the remaining 7.05% is explained by other factors outside the variables studied.

**Table 8: F Test**

| Cross-section fixed (dummy variables) |          |                       |          |
|---------------------------------------|----------|-----------------------|----------|
| R-squared                             | 0.929552 | Mean dependent var    | 1.042751 |
| Adjusted R-squared                    | 0.884066 | S.D. dependent var    | 0.711395 |
| S.E. of regression                    | 0.242223 | Akaike info criterion | 0.289640 |
| Sum squared resid                     | 7.451346 | Schwarz criterion     | 1.612545 |
| Log likelihood                        | 52.58776 | Hannan-Quinn criter.  | 0.824442 |
| F-statistic                           | 20.43603 | Durbin-Watson stat    | 2.917239 |
| Prob(F-statistic)                     | 0.000000 |                       |          |

**Source:** Author's Compilation from Eviews 12, 2023 Output

Based on the F test results in the table above, it is known that the calculated F value is 20.43603. Meanwhile, the F-table value ( $\alpha = 0.05$ ,  $df_1 = 5$  and  $df_2 = 210$ ) is 2.414642. Thus, the calculated F value is greater than the table F value ( $20.43603 > 2.414642$ ). Apart from that, if you look at the probability value, it shows a figure of 0.0000, which means it is smaller than the significance value (0.05). So it can be concluded that the variables leverage, profit quality, KAP reputation and audit committee together have a significant influence on audit quality.

**Table 9: T Test**

| Variable | Coefficient | Std. Error | t-Statistic | Prob.  |
|----------|-------------|------------|-------------|--------|
| C        | 0.884010    | 0.111791   | 7.907699    | 0.0000 |
| LEV_X1   | -0.185092   | 0.055745   | -3.320314   | 0.0012 |
| KL_X2    | -0.013609   | 0.004680   | -2.907698   | 0.0043 |
| RK_X3    | 0.108960    | 0.051721   | 2.106694    | 0.0371 |

**Source:** Author's Compilation from Eviews 12, 2023 Output

Variable X1 (Leverage) has a t-statistic value of  $-3.320314 < 1.971547$  (t-table), with a prob value. (significance) is  $0.0012 (<0.05)$ , so it can be concluded that Variable X1 (Leverage) has a significant effect on Variable Y (Audit Quality). So H1 is accepted.

Variable X2 (Profit Quality) has a t-statistic value of  $-2.907698 < 1.971547$  (t-table), with a prob value. (significance) of  $0.0043 (<0.05)$ , it can be concluded that Variable X2 (Profit Quality) has a significant effect on Variable Y (Audit Quality). So H2 is accepted.

Variable X3 (KAP Reputation) has a t-statistic value of  $2.106694 > 1.971547$  (t-table), with a prob value. (significance) of  $0.0371 (<0.05)$ , it can be concluded that Variable X3 (KAP Reputation) has a significant effect on Variable Y (Audit Quality). So H3 is accepted.

## **Conclusion and Recommendation**

### **Conclusion**

Leverage affects audit quality. These results indicate that the higher the level of leverage, the lower the resulting audit quality. Companies that have a high level of leverage can give an indication that the company is using debt to finance its business operations or increase company profits, so auditors must be careful in examining financial reports so that auditors can provide quality audit results.

Profit quality influences audit quality. This indicates that the higher the quality of profit, the lower the resulting audit quality. Companies that have a high level of profit quality can provide an indication that the company is likely to manipulate its profit to increase investor confidence, so auditors must be careful in examining profit information in financial reports so that auditors can provide quality audit results.

KAP's reputation influences audit quality. This indicates that the higher the credibility of the auditor or public accounting firm, the higher the audit quality produced by the auditor. Companies that choose reputable auditors indicate that the company wants to get quality audit results to

increase investors' confidence in the company's financial reports. Therefore, auditors must continue to maintain their performance in examining financial reports so that they can continue to provide quality audit results.

### **Recommendation**

The study recommends the following :

- i. Company leverage influences audit quality. So the company is expected to be able to control leverage so that audit quality can be produced well.
- ii. The quality of company profits influences audit quality. So the company is expected to be able to provide reliable profit information so that audit quality can be produced well. KAP's reputation influences audit quality. So it is hoped that companies can choose a public accounting firm that has a good reputation so that the audits produced are of high quality.
- iii. For auditors, it is hoped that they can provide advice to all their clients so that in the future the leverage, profit quality and reputation of the KAP must be in a position that supports the achievement of good audit quality.
- iv. For researchers, it is hoped that in future research they can add other dependent variables to find out more about what variables influence audit quality.
- v. As additional knowledge, Leverage and Profit Quality must reflect the actual figures in order to produce a quality audit. Audit quality, KAP reputation and audit committee are audit sciences, all three of which are useful for audit opinion users, so it is hoped that these three things can provide benefits for creditors and investors

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