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Analysis of Governance Diversity and Audit Characteristics on Profitability: Evidence in Indonesia

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Abstract. This study investigates governance diversity-consisting of female members and national diversity in the board of directors and audit characteristics-consisting of quality and audit tenure on profitability with two proxies, return on assets (ROA) and return on equity (ROE). The investigation uses a stewardship theory to explain the effectiveness of the fiduciary relationship between governance and stakeholders. The regression technique uses panel data with 2.151 data from companies listed on the Indonesia Stock Exchange in 2015-2019. This study demonstrates that audit quality has adverse implications for ROA, while other variables have no effect. It`s findings consistent that female members and audit quality reduce fiduciary relationship-meanwhile national diversity and audit tenure do not have any effect on ROE. This study laid to prove the rating of bad corporate governance and suggests to make disruption in corporate governance characteristics.

Keywords: female member, national diversity, audit quality, audit tenure, profitability

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Introduction

The implementation of Good Corporate Governance is a reflection of a company that wants to provide assurance to the parties concerned that the company's management in carrying out its duties acts in the best interests of the company. The implementation of the GCG mechanism is believed to be able to direct the company in creating control of business activities, where its implementation will lead to an increase in company performance and the formation of a good reputation for every aspect of the company.

One topic that is quite influential in the study of corporate governance is board composition (Gianpaolo et al., 2014) because board composition can affect the company's financial performance in which the board is expected to carry out its role effectively. A company generally has a board that comes from a variety of backgrounds. The increasing diversity of boards is believed to increase insights related to the knowledge, ideas, policies, and various approaches required so that in the end it will affect the quality of the company's decision making. It is believed that various boards of directors can have a positive and negative impact on the performance of a company. The higher diversity of board members can lead to more diverse conflicts, but on the other hand, this diversity can be an alternative in finding more varied solutions to a problem compared to homogeneous board members (Astuti, 2017).

Apart from board diversity, the role of the audit as an intermediary between stakeholders such as investors and company managers also needs attention. An audit can be described as a process carried out by auditors to evaluate audit reports related to the use of previously placed funds or budgets (Wulandari & Wirakusuma, 2017). This is the basis for measuring the performance of management towards a company, auditing can support management in improving company performance and creating companies that have good performance. Determining whether the audit characteristics of a company are good can be done by looking at the influence of internal factors and external audit factors, where external factors that can be used as indicators of quality audit characteristics include auditor experience, audit fees, and audit tenure.

The issue of the importance of implementing corporate governance in Indonesia emerged after the prolonged crisis that Indonesia has experienced since 1998. The many issues regarding the weak management structure applied in companies have increasingly attracted public attention due to the disclosure of many cases regarding manipulated financial reports. This encourages the government and investors to pay deep attention to creating effective and efficient company work performance (Aryanti et al., 2014). According to Ferial et al., (2016) good corporate governance implemented in Indonesia is still relatively low, this is stated through the results of a review from the Asian Corporate Governance Association (ACGA) that Indonesia is the country with the lowest rank after China and Korea. The implementation of good corporate governance (GCG) is needed by companies so that consistency and public trust in the company can always be maintained (Aryanti et al., 2014). The application of corporate governance in this study will focus more on the diversity of the board of directors (BOD), especially on the dimensions of gender and nationality, as well as audit assessment factors which include audit quality as measured by looking at the experience of auditors and audit tenure, the amount of audit fees is not included in this study. because the data available is quite limited. The performance or work performance of this company will be analyzed from the ROA and ROE values which are used as a reference to assess whether companies that carry out corporate governance system arrangements have a good performance or not.

Literature Review

Number of Female Board Member and Company Performance

Astuti (2017) considers the behavior of women who tend to be more careful and more vigilant in facing the risk of making company decision-making not rushed. With the presence of women on the board of directors it is believed that they are able to consider every element so that decisions are made more precisely with a low level of risk, which leads to an increase in the company's work performance.

According to Kristina & Wiratmaja (2018), board diversity and corporate governance have a strong relationship in matters relating to upper-level management, the company board has the authority to lead the company and create goals and is responsible for all decisions that have been made. The presence of women on the board is still quite low because there are different views about men and women in managing a company. This diversity is able to add value to the company because gender variations prove that companies offer opportunities to anyone without discrimination, this certainly can create good opportunities for investors so that it leads to an increase in the reputation of the agency (Kristina & Wiratmaja, 2018).

Based on the theoretical and empirical literature above, the first hypothesis of the study is as follows:
H1a. The number of female board members has no significant effect on company performance (ROA).
H1b. The number of female board members has no significant effect on company performance (ROE)

Foreign Directors and Company Performance

Kristina & Wiratmaja, (2018) stated that the diversity of citizenship is one of the diversities that companies also need to pay attention to, the presence of foreign nationals is believed to present varied arguments and perspectives, languages, religions, basic education, and various professionalism skills in each country.

Astuti (2017) explains that with the presence of a composition of foreign nationals on the board, a company can increase the reputation that the company has established, because in general, boards with foreign citizenship tend to appear to have superior abilities and professional attitudes in certain aspects where this also leads to an increase. company performance.
H2a. Foreign directors on the board have no significant effect on company performance (ROA)
H2b. Foreign directors on the board have a significant negative effect on company performance. (ROE)

Audit Quality and Company Performance

Investors, shareholders and other stakeholders are certainly looking for accurate and relevant financial data as decision makers, this data can be obtained through audited financial reports where auditing reports and providing opinions on assessments is the duty of the auditor. Al Ani & Mohammed (2015) revealed that audit quality can increase company value, which results in increased demand for audit quality. Researchers conclude that many studies suggest that larger audit firms are able to provide a higher quality of reporting and presentation of corporate financial information.

The literature proves that the experience of auditors proxied by the big 4 plays an important role in determining audit quality, where the big 4, which has more resources, is said to be superior to the non big 4 (Al Ani & Mohammed, 2015).

Based on above theoretical and empirical literature. Third hypothesis of study is as follows:
H3a. Audit quality has no significant effect on company performance (ROA)
H3b. Audit quality has no significant effect on company performance (ROE).

Audit Tenure and Performance Audit

Pramaswaradana (2017) states that audit tenure related to the audit engagement period is considered to be able to create an excessive relationship of intimacy if it is carried out within a long grace period, the existence of close proximity between parties can cause the auditor's assessment to be not objective and decrease auditor independence. The issuance of the auditor rotation policy regarding limiting the tenure of public accountants in providing audit services for the company is considered to be quite effective, this is expected to be able to prevent closeness between the two parties so that the auditor will not face independence problems. As written in the Minister of Finance Regulation (PMK) No. 17 of 2008, KAP is given a time limit to provide audit services within a period of three years, while for public accounting firms, it is given a time limit of five consecutive years.. Based on above theoretical and empirical literature forth hypothesis of study is as follows:
H4a. Audit tenure has no significant effect on company performance (ROA).
H4b. Audit tenure has no significant effect on company performance (ROE).

Firm Size and Company Performance

Melia Agustina Tertius (2015) says that firm size is an element that can be described as a reference in determining how big a company is. The size of the company has an important relationship with company performance where companies on a large scale tend to be easier to secure finances, get a superior level of interest, a higher discount rate that is in line with large-scale purchases, and gain greater power over market control (Sayyar et al., 2015).

Sekar et al., (2018) argue that large companies in general are easier to get attention and are glimpsed by the public and investors, so this encourages companies to be more thorough and accurate in carrying out financial reporting. On the other hand, Kristie Onasis (2016) argues that the larger the size of the company will result in more diversity and complexity in the size of the board, which will lead to reduced performance of the company itself.

Leverage and Company Performance

According to Ahmed & Hamdan (2015), the level of debt of a company has the potential to affect financial performance due to financial costs and risk of default, corporate leverage is created when shareholders borrow money for investment in securities. The high amount of debt to a company has a negative impact on the accounting performance of a company, but has a positive impact on the market size of the company's performance (Bansal & Sharma, 2016).

Firm Age on Company Performance

Kristie Onasis, (2016) said that the influence of company performance can be seen from the age since the company was founded, where companies that have been established for a long time usually have a more complex, branched, or split share ownership structure so that this is believed to result in a decrease in company value.

On the other hand, Adeline & Jogi (2017) assume that companies with a younger age are relatively more creative and are more ready to face any changes and competition between business actors that is tighter than companies with older age.

Research Methods

Research carried out using quantitative testing, where this test focuses on the theory obtained through the variables studied in the form of numbers and the data is described by statistical analysis procedures. This test uses a deductive approach in order to evaluate the hypothesis. Deductive interpretation is a process where conclusions are drawn based on specific things to be researched or things that have previously been proven true (Rahmah, 2018).

The object of research that is managed in this test is companies listed on the Indonesia Stock Exchange starting from 2015 to 2019. The data used is research material sourced from the presentation of financial information in the form of annual reports that have been published by companies listed on the Indonesia Stock Exchange. Sampling in this test is to use the purposive sampling method, where the required information can be taken from groups or targets that meet certain benchmarks that have been set in line with the objectives of this research. Samples are selected based on Judgment Sampling, where the sample is selected by considering certain things so that it is aligned with the objectives of the test and research problems.

Variables of Study

Dependent variable of the study is firm performance and it is measured by two proxy variables. First one is ROA and it is calculated by dividing profit after tax with total assets. ROA is best indicator for using as a proxy of firm performance because it demonstrates how well management utilized available resources.

Second variable for measuring firm performance is ROE calculated by dividing net income to equity. The approach of using both ratio as proxy of form performance is in line with Khan & Abdul Subhan (2019). Board diversity is evaluated by two proxy variables including number of female board members and nationality diversity of board members. No of female board members is measured by total number of female directors present in board. Female board member as independent variable of firm performance is also consistent with research work of Khan & Abdul Subhan (2019).

Nationality diversity is measured by observing either different nationality board members exist in board or directors or not. Quality audit is measured by investigating that either firm is hiring services of higher quality external auditing firms are not. This variable is measured as dummy variable. It will be 1 in case of company using KAP Big 4 and would be 0 in case of company using KAP Non Big 4. The quality audit variable has been used in research work of Astuti (2017). Audit tenure is a variable related to the rotation of a public accounting firm in a company, measured by dummy variable. Given 1 if there is auditor rotation, and given 0 if there is no auditor rotation. Pramaswaradana (2017) explored the linkage between firm performance and audit cost.

Firm size is represented by total assets of the firm and in current study this variable has been used as control variable of the study. Leverage as a control variable in this study is measured by making a comparison between the company's total debt and the company's total assets. Firm age as the control variable in this study is measured by looking at the company establishment date until the year this research was conducted. Control variables of this study are consistent with research work of Hassan et al., (2015) for firm size and Rosa Dewinta & Ery Setiawan, (2016) for leverage and firm age. Summarized model specification for both models are represented below in table 1.

Table 1
Model spesification

Symbol	Variable	Description
ROA	Return on assets	Profit after tax / total assets
ROE	Return on equity	Profit after tax / total equity
NFM	Number of female board members	Number of females in BOD
ND	Nationality diversity	Different nationality members in BOD
AE	Audit Experience	Different auditor certification in company
AT	Audit Tenure	Different auditor rotation in company
FS	Firm Size	Total assets of the firm
FL	Leverage	The level of debt of the firm
FA	Firm Age	The age of company

Results and Discussion

This test was taken from financial report data for 5 consecutive years, from 2015 to 2019, totaling 2570 data. As for the data containing outliers as many as 259 data so that after deducting the total final data in this study were 2151 data. The data that has been collected will be managed using special software for data testing called the SPSS (Statistical Package for the Social Sciences) program version 12 and Eviews 10. The following are the techniques used in the research.

Descriptive statistics

This technique provides information related to the estimated data to be studied, such as the amount of data, minimum and maximum values, what is the average, standard deviation, and so on. The results of descriptive statistics on quantitative data in this research are shown in table 2 and table 3.

Table 2
Quantitative descriptive statistics

	N	Min	Max	Mean	Std.Dev
ROA	2151	-27.156	51.755	2.711	6.899
ROE	2151	-141.96	158.117	4.471	18.574
NFM	2151	0	5	0.65	0.852
FS	2151	25.557	54.148	28.877	1.716
FL	2151	0.010	1.850	0.501	0.254
FA	2151	0	74	51.75	15.550

Table 3
Qualitative descriptive statistics

Variabel		Frequency	Percent
ND	0	1448	67.9
	1	685	52.1
AE	0	1526	62.2
	1	805	57.8
AT	0	1124	52.7
	1	1004	47.5
Valid N		2151	

Table 2 shows that ROA and ROE have a mean value of 2.71 and 4.47, respectively, the number of female board members has an average of 0.65, firm size has a mean of 28.88, leverage has a mean of 0.5, and company age has an average 51.75.

Table 3 shows that of the 2151 national diversity (ND) data studied, there were 685 companies or 52.1% of which there were ethnic differences in the companies and as many as 1448 companies or 67.9% there were no national diversity in the companies. Testing on the experience of auditors representing research on the Audit Quality variable (AuditExp) shows that from 2151 valid samples it can be concluded that 1526 companies or 62.2% use KAP Non Big 4 and 805 companies or 57.8% use KAP Big 4. Tests on Audit Tenure (AT) show that from 2151 samples, it is known that as many as 1007 companies or 47.5% experienced a change in KAP and as many as 1124 companies or 52.7% did not change KAP.

Chow Test

Research on company performance variables as the dependent variable shows the probability value of the tested data of 0.0000 on the measurement of the rate of return on assets and equity. This means that it is necessary to do the Hausman test as a further test because the best model to be used is the fixed effect model. Table 4 below presents the Chow test results.

Table 4
Chow Test Results with ROA and ROE as Measures of Company Performance

Variabel Dependen	Effects Test	Prob.	Kesimpulan
ROA	Cross-section Chi-square	0.0000	Fixed Effect Model
ROE	Cross-section Chi-square	0.0000	Fixed Effect Model

Hausman Test

The results of the company performance test on the Hausman test prove that the best model used is the fixed effect model because the probability value in the data tested is below 0.05, which is 0.0015 and 0.0022. Below is the Hausman test result.

Table 5
Hausman Test Results with ROA and ROE as Measures of Company Performance

Dependent Variable	Effects Test	Prob.	Conclusion
ROA	Cross-section Random	0.0015	Fixed Effect Model
ROE	Cross-section Random	0.0022	Fixed Effect Model

F Test

The regression results in Table 6 show that the significant value of the company performance variables proxied by ROA and ROE is below 0.05, which is equal to 0.0000, so it can be concluded that the F test in this study is fulfilled. Therefore, the fixed effect model regression method in this test can be used to investigate company performance variables.

Table 6
F Test Results with ROA and ROE as Measures of Company Performance

Dependent Variable	Sig.	Conclusion
ROA	0.0000	Model can be used
ROE	0.0000	Model can be used

Uji t

The t test was carried out in order to detect the attachment of each independent variable to the dependent variable. The results of the t test using a fixed effect model on testing company performance can be based on Table 7 and Table 8.

Table 7
t Test Results with ROA as Measures of Company Performance

Variables	Coefficient	t-Statistic	Sign.	
C	-2.625701	-0.274262	0.7859	-
NFM	-0.547100	-1.199611	0.2505	(?)
ND	-0.155202	-0.247259	0.8048	(?)
AE	-1.509547	-2.154715	0.0515	(-)
AT	-1.701525	-0.559274	0.7544	(?)
FS	0.459422	1.540710	0.1802	(?)

Note: (-) is negative and significant, (+) is positive and significant, (?) Is not significant or has no effect, n.a. (not available) is not a research hypothesis

Table 8
t Test Results with ROE as Measures of Company Performance

Variables	Coefficient	t-Statistic	Sign.	
C	40.91125	1.249018	0.2118	-
NFM	-2.297588	-2.520755	0.0204	(-)
ND	1.164145	0.651565	0.5278	(?)
AE	-4.525792	-2.080568	0.0576	(-)
AT	-4.452540	-0.259524	0.7955	(?)
FS	-0.719017	-0.615292	0.5598	(?)

Note: (-) is negative and significant, (+) is positive and significant, (?) Is not significant or has no effect, n.a. (not available) is not a research hypothesis

The results of hypothesis testing can be seen in table 7 and table 8. Broadly speaking, this study shows that audit quality has bad implications for ROA, while other variables have no effect. The findings were consistent that female membership and audit quality decreased the fiduciary relationship while national diversity and audit tenure did not have any effect in the context of ROE. The decline in the relationship between female members is due to the low proportion of women on the board of directors. Women's lack of courage in taking risks is the reason why women have a lower percentage in the composition of the board of directors than men. As for foreign citizens who do not affect the research, it is because most Indonesian companies do not have foreign citizens on their board of directors, so the national diversity variable is less varied. The bad effect of audit quality on company performance is due to the low use of Big 4 KAP based on the descriptive test results of qualitative data in table 3, the higher percentage of KAP Non Big 4 leads to distrust of investors or shareholders of the company that has been audited. The insignificant research results on audit tenure are caused by the average company in Indonesia that tends not to change external auditors in order to maintain auditor independence, where the data can be referred to in the descriptive statistical test results table 3.The high average leverage value described Table 2 shows a decrease in the fiduciary relationship. The addition of the company's total assets by borrowing funds makes the company's management less efficient in using its assets to generate profits, the addition of debt that is greater than the profit generated through assets certainly increases the company's risk.

Conclusions

The research study found a significant negative relationship between audit quality on ROA and ROE as a measure of company financial performance. Another finding that the number of women on the board shows bad implications in the context of ROE and has no effect on ROA, while national diversity and audit tenure do not have any effect in the context of ROA and ROE. The results of this study prove that the board structure of the company is still less varied and the awareness of maintaining audit quality is still low. Referring to the research results, it is hoped that women and foreign nationals can be given more space in the board of directors to take part in managing the company. In the context of using external audit services, companies are expected to use Big 4 KAP and make audits in accordance with applicable regulations, this action is also intended to maintain the reputation and trust of outsiders in the company.

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