

The Effect of Protection for Investors, Sharia Financial Accounting Standards, Good Corporate Governance on Audit Quality and Their Implications on Profit Quality of Sharia Commercial Banks in Indonesia

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Abstract

*This study aims to estimate and analyze the effect of investor protection, Islamic financial accounting standards, and good corporate governance on audit quality and their implications for earnings quality, either partially or jointly. The sample used is 11 Islamic commercial banks in Indonesia in 2013-2019 so that the observed data are 77. The research method used is a quantitative research method with panel data regression analysis. The results show that, in the first model, partial protection for investors has a significant positive effect, Islamic financial accounting standards have a significant positive effect, and good corporate governance has a significant positive effect on audit quality. Taken together, investor protection, Islamic financial accounting standards, and good corporate governance have a significant effect on audit quality $b=0.837185$, so the model equation is $KAU = [Ci + 0.837185] + 0.182762 * PBI + 0.218712 * SAS + 0.309210 * GCG$. In the second model, partial protection for investors has an insignificant negative effect, Islamic financial accounting standards have a significant positive effect, good corporate governance has a significant positive effect, and audit quality has a significant positive effect. Taken together, investor protection, sharia financial accounting standards, good corporate governance and audit quality have a significant effect on earnings quality, so the equation of the model is $KALA = [Ci + 0.492812] - 3.940632 * PBI + 0.582245 * SAS + 1.357672 * GCG + 0.966662 * YOU$.*

Keywords

protection for investors; islamic financial accounting standards; good corporate governance; audit quality; earnings quality



I. Introduction

The development of Islamic banking in Indonesia cannot be separated from the development and progress of Islamic banking in the international world. The Islamic finance industry is growing rapidly, especially after the promulgation of Law Number 21 of 2008 concerning Islamic Banking as *lex specialis* of Law Number 10 of 1998 concerning amendments to Law Number 7 of 1992 concerning Banking. The enactment of this law is also motivated by the increasing need for Islamic banking services by the Indonesian people, in addition to the specificity of Islamic banking compared to conventional banking in terms of prohibiting the practice of collecting usury with the aim of protecting customers from exploitation of usury (bank interest).

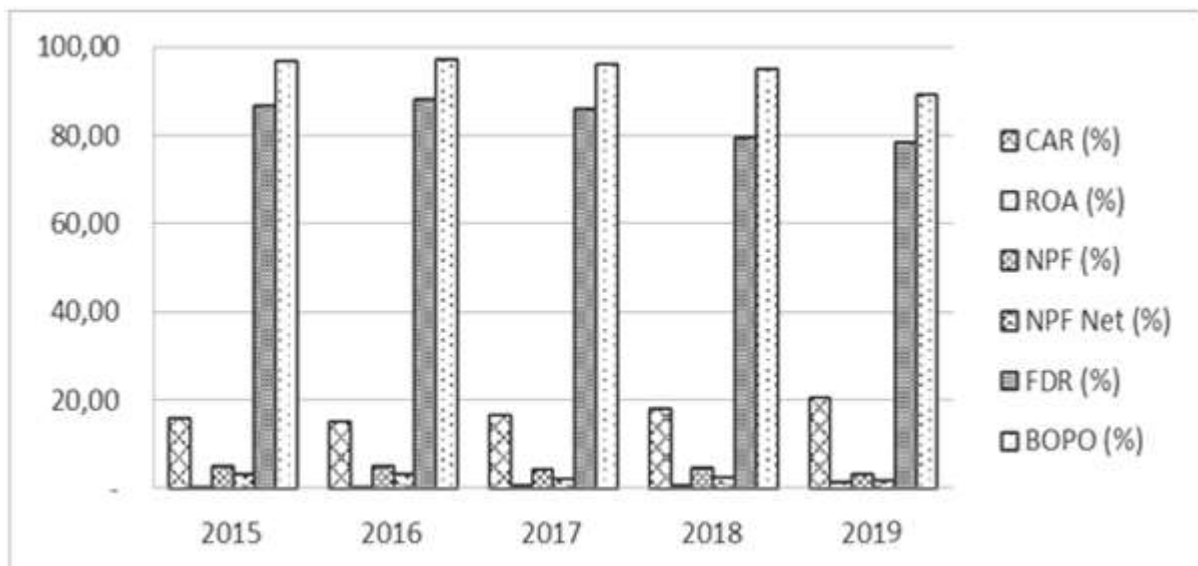
Financial performance is a measuring instrument to know the process of implementing the company's financial resources. It sees how much management of the company succeeds, and provides benefits to the community. Sharia banking is contained in the Law of the Republic of Indonesia No.21 of 2008 article 5, in which the Financial Services Authority is assigned to supervise and supervise banks. (Ichsan, R. et al. 2021).

Further developments based on Law No. 21 of 2011 the task of supervising the banking sector shifted to OJK on December 31, 2013. Since the enactment of the law, it has become a breath of fresh air for the Islamic banking industry. The number of assets, office network and Islamic banking workforce is growing very rapidly. Table 1. shows the development of total assets, office network and sharia banking workforce from 2015 to 2019.

Table 1. Development of Total Assets, Office Network and Manpower of Islamic Commercial Banks (Nominal in Billions of Rupiah)

Indicator	2015	2016	2017	2019	2019
Total Aset	204.961	213.423	254.184	288.027	316.691
Jumlah Bank	12	12	13	13	14
Jumlah Kantor	2.163	1.99	1.869	1.825	1.875
- KC	447	450	473	471	478
- KCP	1.511	1.34	1.207	1.176	1.199
- KK	205	200	189	178	198
ATM	3.35	3.571	3.127	2.585	2.791
Jumlah Tenaga Kerja	41.393	51.413	51.11	51.068	49.516

Source: Statistics of Indonesian Islamic Banking (data processed)



Source: Statistics of Indonesian Islamic Banking (data processed)

Figure 1. Financial Ratios of Islamic Commercial Banks

The profit growth generated by Islamic banks must indeed be maintained for the sake of the continuity of the performance of Islamic banking because when the performance of Islamic banks declines, the public's trust in the bank will also decrease and the profitability of the bank will also have an effect such as the decline in bank profits on its business activities (Erlangga and Mawardi, 2016).

In the 2016 Indonesian Institute of Accountants Conceptual Framework, it is stated that the purpose of general purpose financial reporting is to provide financial information about the reporting entity that is useful to current and potential investors, lenders and other creditors in making decisions about providing resources to the entity. Although the usefulness of financial information requires quality, research results show that financial

information or accounting information is not always of high quality. The quality of accounting information with a focus on earnings information is important information in investment decisions.

Audits are conducted to ensure that Islamic banks can enforce sharia governance and at the same time increase stakeholder trust. However, there is often a possibility of a difference of interest between management and users of financial statements regarding the gaps in the information provided. In the end, the role of a competent and independent third party is needed to conduct an examination of the financial statements (Al-Thuneibat and Baker, 2011).

A public accountant is the most appropriate profession as a third party and acts as an auditor to carry out the audit function. Public accounting services are needed to guarantee the relevance and reliability of the company's financial statements, to prove that the financial statements presented by management are free from material misstatement, so as to increase the confidence of the parties concerned regarding the company. However, the emergence of accounting scandals in recent years provides further evidence of audit failures with serious consequences for the business community.

There are many factors (both external and internal) that influence the ethical attitudes and behavior of Public Accountants. Based on the 2016 Association of Certified Fraud Examiners (ACFE) report, that the most common type of fraud is fraudulent financial statement fraud, which accounts for the largest losses than other frauds.

Low audit quality and the occurrence of engineering in financial statements will distort earnings quality and in the end can make decision making by stakeholders less precise. (Schipper and Vincent, 2003) stated that low earnings quality will disturb investors and other users of financial statements so that it can cause capital allocation errors. This is certainly a question for many related parties, what are the external and internal factors that affect audit quality and earnings quality. .

Protection for investors is considered capable of enhancing audit quality, this has been developed by (La Porta et al., 1997, 1998, and 2006) namely legal tradition, corporate law and enforcement, and securities law. These measurement variables have been used by studies after those related to investor protection such as (Leuz, Nanda, and Wysocki, 2003), (Thai et al., 2006), (Bushman and Piotroski, 2006), (Francis and Wang , 2006), and (De Fond and Hung, 2007). Protection for investors will affect the audit quality of external auditors. The role of the independent auditor is to provide verification services by outside parties for the fairness of accounting numbers.

Several international studies (such as Ali and Hwang, 2000), (Ashbaugh and Lafond, 2003), (Ball, Kothari, and Robin, 2000), (DeFond, Hung, and Trezevant, 2004), (Hung, 2001), (Leuz , Nanda, and Wysocki, 2003) have examined the relationship between several measures of earnings quality across countries and legal protection for investors from expropriation by both controlling shareholders and managers. The results of the study conclude that earnings quality is influenced by protection for investors. Other international studies such as (Ali & Hwang, 2000), (Ashbaugh & LaFond, 2003), (Ball, Kothari, & Robin, 2000), (DeFond, Hung, & Trezevant, 2004), (Hung, 2001), (Leuz , Nanda, & Wycoski, 2003) have examined the relationship of investor protection with inter-country earnings quality measures of expropriation by both controlling shareholders and managers. The results of these studies indicate that the quality of corporate earnings varies between countries due to differences in legal systems and law enforcement relating to investor protection.

The quality of earnings in Islamic banks is also influenced by financial accounting standards, especially Islamic financial accounting standards that apply in a country. Flexibility in principles-based international financial accounting standards will have an impact on the type and number of professional skills that accountants and auditors should have. The adoption of international financial accounting standards, especially Islamic financial accounting standards, requires accountants and auditors to have an understanding of the conceptual framework of financial information so that they can be applied appropriately in decision making and have sufficient knowledge about fundamental business and economic events and transactions in Islamic banks before making judgments. (Benneth et al., 2006) concluded that principles-based requires professional judgment.

The role of the auditor in the company's financial reporting process will also be largely determined by how good corporate governance (GCG) is implemented in a company (Francis and Wang, 2006). GCG implementation in a company also affects earnings quality. Various previous studies have documented the relationship between several GCG mechanisms on several earnings quality measures such as earnings management (Dechow et al., 1996), (Klein, 2002), (Xie et al., 2003), (Siregar, 2005), (Dhaliwal, 2005). et al., 2007), the information content of earnings (Niu 2006 and Petra 2007), and the degree of accounting fraud (Beasley, 1996). Based on the results of these studies, it can be concluded that in general the GCG mechanism can reduce management incentives to manipulate earnings so that earnings quality becomes better and contains better information for investors.

As described above, the importance of audit quality because it can affect the quality of earnings and the allocation of other economic resources. The thing that attracts attention in this research lies in; First, this study attempts to investigate the effect of GCG on audit quality and its implications for earnings quality more broadly by considering the company's legal environment related to investor protection and Islamic financial accounting standards. Second, in this study, the variables of Islamic financial accounting standards adopted from AAOIFI (Accounting and Auditing Organizations for Islamic Financial Institutions) were used. The reason for using Islamic financial accounting standard variables is because basically Islamic financial accounting standards recognize universal logical opinions in accordance with the nature of truth that comes from the Qur'an and Sunnah. Third, this research is in the context of developing countries such as Indonesia, which have diverse institutional characteristics and countries that have huge growth potential for Islamic banking. With the diversity of characteristics in Indonesia, this research becomes very interesting.

Theoretically, this research is expected to provide benefits for the development of science, practitioners, and regulatory interests. For the development of science, this research is expected to be able to contribute in the form of additional knowledge building regarding the effect of protection for investors, Islamic financial accounting standards, GCG, on audit quality and its implications for earnings quality by providing more comprehensive empirical evidence.

For financial practitioners, in this case investors, auditors, and accountants, this research is expected to provide benefits through increasing insight into the factors that affect earnings quality. Thus, accountants and auditors can report earnings with better quality and Islamic banking investors can use these financial statements in making wiser decisions.

II. Review of Literature

2.1 Entity Theory

Agency theory (entity theory) developed by (William Paton, 1922) and further developed by (Fama, 1970) is a response to the emergence of an ownership view of the company. According to this theory, the company is a separate entity and has its own identity. Although the company is not an individual so that it cannot act in its interests, the company is something real and its existence can be measured (Bricker and Chandar, 1998).

2.2 Agency Theory

(Jensen & Meckling, 1976) defines an agency relationship as a contract in which one or more persons acting as principals (ie shareholders/shareholders) appoint another person as an agent (ie manager) to perform services for the principal's interests, including delegating power in decision making to the agent. The agency relationship will cause conflict if the manager tries to maximize his personal utility at the expense of the owner's welfare.

2.3 Signalling Theory

Companies are often faced with quality differences between them, such as the quality of business strategies, information, resources, and also the quality of financial reporting. To communicate these differences, companies must provide signals to investors. (Scott, 2009) defines signaling as: a signal is an action taken by a high-type manager that would not be rational if that manager was low-type.

2.4 Positive Accounting Theory

The development of positive theory cannot be separated from dissatisfaction with normative theory (Watt & Zimmerman, 1986). Watt & Zimmerman stated that the rationale for analyzing accounting theory in a normative approach is too simple and does not provide a strong theoretical basis. To reduce the gap in the normative approach, Watt & Zimmerman developed a positive approach that is more oriented towards empirical research and justifies various accounting techniques or methods currently used or looks for new models for the development of accounting theory in the future.

2.5 Transaction Cost Economics Theory

This approach was first proposed by (Cyert and March, 1963) which was later developed by Williamson in the mid-1970s by arguing that small-scale transactions (such as simple exchange transactions of goods and services) do not require organization. However, when the transaction becomes more complex (complexity) and increasingly uncertain (uncertainty), then the existence of an organization is needed to monitor and limit obligations and the various risks that arise.

2.6 Stewardship Theory

According to this theory, organizational structure is very important in order to empower the role of stewards and give them full autonomy based on trust (Donaldson and Davis, 1991). Their position is very important in order to act more economically so as to maximize the welfare of the principals. By maximizing shareholder returns, stewards will have a good reputation so they can re-enter the market in the future (Shleifer and Vishny, 1997).

2.7 Stakeholder Theory

Stakeholder theory seeks to explain to which parties the company must be responsible, and in this case the company must maintain relationships with stakeholders which is carried out by accommodating their various interests, especially those who have bargaining power over the availability of company resources (Freeman, 1984).

2.8 Audit Quality

(De Angelo, 1981) defines audit quality as a market assessment of the probability that the auditor will find a violation in the client's accounting system and report the violation. The effect of audit quality on earnings quality has been documented by several previous studies. (Becker et al., 1998) stated that companies audited by non-Big 6 public accounting firms contain a higher discretionary accrual value than companies audited by Big 6 public accounting firms. Meanwhile (Teoh and Wong, 1993) stated investor response to company profits is greater in companies audited by Big 8 accounting firms compared to companies audited by Non Big 8 accounting firms.

(Carcello and Nagy, 2002) provide evidence of a negative relationship between auditor specialization in the client's industry and reprimands from the capital market watchdog (SEC). Meanwhile (Dunn et al., 2000) proves that financial analysts give a better rating on the quality of disclosure for companies audited by specialists. Furthermore, (Gramling et al., 2001) proves that the earnings of companies audited by specialist auditors will provide more accurate predictability of future cash flows compared to companies audited by non-specialist auditors. (Francis et al., 2001) examines the role of the protective legal framework for investors in explaining country differences regarding the role of accounting and auditing in good corporate governance. Their research concludes that common law countries have more transparent public disclosures and more timely accrual-based accounting systems.

Then, (Francis and Wang, 2006) examined the relationship between audit quality and reported earnings quality for firms from 42 countries. They prove that earnings quality increases for companies that use the services of Big 4 auditors when protection for investors in the countries where they operate is stronger. On the other hand, profits for companies with non-Big 4 auditors are not affected by the protection conditions for investors. Thus, their research concludes that there is an incentive for Big 4 auditors to provide higher quality audits in countries that have stronger investor protection.

III. Research Method

This study uses quantitative methods with panel data regression analysis. This study aims to estimate and analyze the effect of investor protection, Islamic financial accounting standards, and good corporate governance on audit quality and their implications for earnings quality, either partially or jointly. The research population is Islamic commercial banks in Indonesia, totaling 14 banks in 2013 – 2019. The sample used is 11 banks so that the observed data is 77. The sample criteria are Islamic commercial banks registered and supervised by the Financial Services Authority (OJK) and generally routinely publish complete annual financial reports according to research variables. The sample banks were: 1) PT Bank Muamalat Indonesia, 2) PT Bank Syariah Mandiri, 3) PT Bank Mega Syariah, 4) PT Bank Syariah Bukopin, 5) PT Bank BRISyariah, 6) PT Bank Panin Dubai Syariah, 7) PT Bank BCA Syariah, 8) PT Bank Jabar Banten Syariah, 9) PT Bank BNI Syariah, 10) PT Bank Victoria Syariah, and 11) PT Bank Maybank Syariah Indonesia.

Table 2. Operational Variables

Variable	Draft	Measurement	Proxy	Scale
Protection for Investors	Independent commissioners are parties who fight for the interests of investors.	The existence of an independent commissioner	<i>Scoring : Independent Commissioner / Number of Commissioners</i>	Ratio
Sharia Financial Accounting Standards	International financial reporting standard	Sharia PSAK Ratio adopted	<i>Scoring : (Adopted Sharia PSAK / Total Sharia PSAK)</i>	Ratio
<i>Good Corporate Governance</i>	Aspects of governance structure, governance process and governance outcome.	Categorization of self-assessment implementation ranking	<i>Scoring : Rating of Good Corporate Governance</i>	Ratio
Kualitas Audit	Assessing the fairness of financial statements.	Competence, independence, specialization, tenure audit, peer review, affiliation.	<i>Scoring : (Score obtained/6) x 100%</i>	Ratio
Kualitas Laba	Net profit stability from year to year.	<i>Earning quality ratio</i>	<i>Scoring : Operating Cash Flow / Net Profit</i>	Ratio

IV. Results and Discussion

4.1 Testing the Audit Quality Determinant Model

The panel data regression model used in testing the audit quality determinant model consists of three models, namely common effect, fixed effect, and random effect. To choose which model to use, a paired test was carried out for each model. Based on the results of paired testing using the Chow Test, Langrange Multiplier Test, and Hausmant Test, it can be concluded that the model used in panel data regression to estimate the effect of investor protection, Islamic Financial Accounting Standards, and Good Corporate Governance on Audit Quality for 11 Islamic commercial banks in Indonesia in 2013-2019, is a fixed effect model because it has the largest R Square value, which is 0.818340 or 81.8340%.

4.2 Testing the Implication Model on Earnings Quality

The panel data regression model used in testing the implication model on Earnings Quality consists of three models, namely common effects, fixed effects, and random effects. To choose which model to use, a paired test was carried out for each model. Based on the results of paired testing using the Chow Test, Langrange Multiplier Test, and Hausmant Test, it can be concluded that the model used in panel data regression is to estimate the effect of investor protection, Islamic financial accounting standards, good corporate governance and audit quality on earnings quality for 11 banks. general sharia law in Indonesia in 2013-2019, is a random effect model because it has the largest R Square value of 0.859833 or 85.9833%. This random effect model is a panel data regression model that eliminates the problem of heteroscedasticity by constanting the residuals using white-

heteroscedasticity, while the problem of autocorrelation is not required in the random effects model so that the autocorrelation test can be ignored (Nachrowi, 2006).

4.3 Determination of Audit Quality and Implications for Earnings Quality

The results show that, in the first model, partial protection for investors has a significant positive effect, Islamic financial accounting standards have a significant positive effect, and good corporate governance has a significant positive effect on audit quality. Taken together, protection for investors, Islamic financial accounting standards, and good corporate governance have a significant effect on audit quality. In the second model, partial protection for investors has an insignificant negative effect, Islamic financial accounting standards have a significant positive effect, good corporate governance has a significant positive effect, and audit quality has a significant positive effect. Taken together, investor protection, Islamic financial accounting standards, good corporate governance and audit quality have a significant effect on earnings quality.

Table 3. Determinants of Audit Quality and Its Implications on Earnings Quality

Variable Independent	Model 1 (Quality Audit)			Model 2 (Quality of Earnings)		
	Coefficient Regression	Prob	Sig/No Significant	Coefficient Regresi	Prob	Sig/No Significant
PBI	0.182762	0.0328	Significant	-3.940632	0.9142	Not significant
SAS	0.218712	0.0465	Significant	0.582245	0.0049	significant
GCG	0.309210	0.0069	Significant	1.357672	0.0000	significant
KAU				0.966662	0.0053	significant

Source: Processed by the author

The Contribution Coefficient or R Square of Structural Equation II is 0.859833 (85.98%) which is greater than the Contribution Coefficient or R Square of Structural Equation I of 0.818340 (81.83%) even though there is an insignificant effect of independent variables (ie Protection for Investors) . This is influenced by the audit quality variable with a coefficient value of 0.966662 as an intervening variable and the increase in the coefficient value of the Islamic financial accounting standard variable in equation I is 0.218712 and in equation II is 0.582245. The increase in the coefficient value also occurs in the GCG variable, namely in equation I the GCG coefficient value is 0.309210 in equation II the GCG coefficient value is 1.357672.

Summary of research results for the combination of the two panel data regression models in this study. The explanation is as follows:

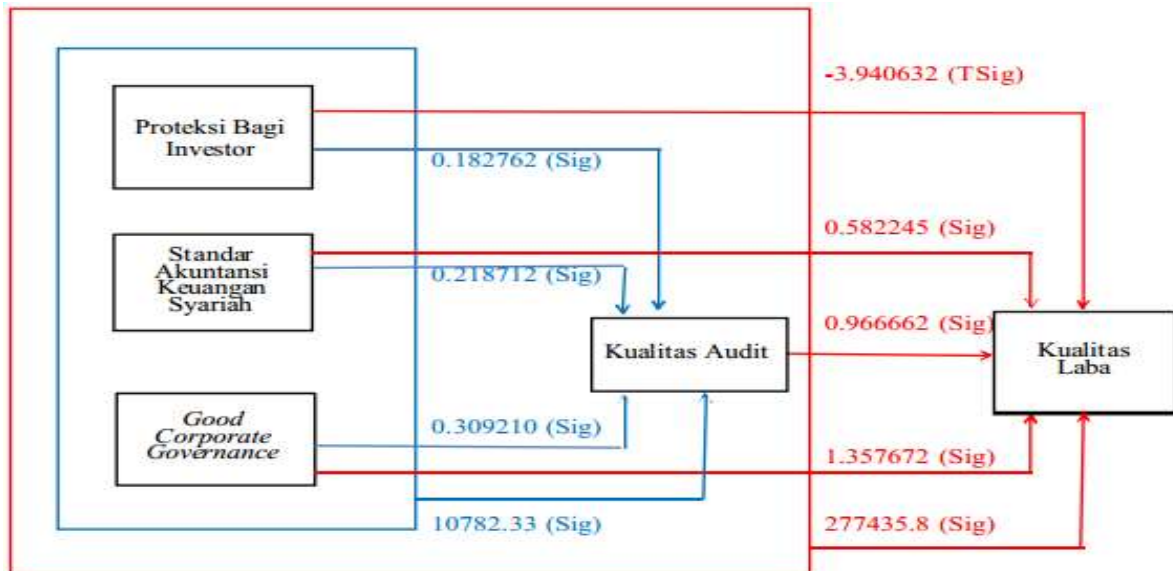


Figure 3. Summary of Research Results

V. Conclusion

In accordance with the formulation of the problem, research objectives, framework of thought and hypotheses, the conclusions from the research results are as follows:

1. Protection for investors affects audit quality positively and significantly. This finding is in line with the research hypothesis which states that investor protection has a positive effect on audit quality in Islamic commercial banks for the 2013-2019 period.
2. Islamic financial accounting standards (SAS) positively and significantly affect audit quality. This finding is in line with the research hypothesis which states that SAS has a positive effect on audit quality in Islamic commercial banks for the 2013-2019 period.
3. Good Corporate Governance (GCG) positively and significantly affects audit quality. This finding is in line with the research hypothesis which states that the implementation of GCG has a positive effect on audit quality in Islamic commercial banks for the 2013-2019 period.
4. All independent variables (investor protection, SAS, and GCG) together significantly affect audit quality. This finding is in line with the research hypothesis which states that investor protection, SAS, and GCG jointly affect audit quality in Islamic commercial banks for the 2013-2019 period. The value of the coefficient of determination (R^2) of 0.818340 indicates that all independent variables can explain variations in the ups and downs of audit quality by 81.83% while the remaining 18.17% is explained by other factors not included in the model. Furthermore, compared to other independent variables in influencing audit quality, the GCG variable has the most dominant influence while SAS has the least influence.
5. Protection for investors affects earnings quality negatively but not significantly. This finding is not in line with the research hypothesis which states that investor protection has a positive effect on earnings quality in Islamic commercial banks for the 2013-2019 period.
6. Islamic financial accounting standards (SAS) affect earnings quality positively and significantly. This finding is in line with the research hypothesis which states that SAS has a positive effect on earnings quality in Islamic commercial banks for the 2013-2019 period.

7. Good Corporate Governance (GCG) affects earnings quality positively and significantly. This finding is in line with the research hypothesis which states that GCG has a positive effect on earnings quality in Islamic commercial banks for the 2013-2019 period.
8. Audit quality affects earnings quality positively and significantly. This finding is in line with the research hypothesis which states that audit quality has a positive effect on earnings quality in Islamic commercial banks for the 2013-2019 period.
9. All independent variables (investor protection, SAS, GCG, and audit quality) together significantly affect earnings quality. This finding is in line with the research hypothesis which states that investor protection, SAS, GCG, and audit quality together affect earnings quality in Islamic commercial banks for the 2013-2019 period. The value of the coefficient of determination (R²) of 0.859833 indicates that all independent variables can explain variations in the ups and downs of earnings quality by 85.98% while the remaining 14.02% is explained by other factors not included in the model. Furthermore, compared to other independent variables in influencing earnings quality, the GCG variable has the most dominant influence while protection for investors has the least effect.

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