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Determinant of Corporate Governance, Audit Quality and Financing Decision

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Abstract
This paper investigates the effect of both corporate governance and audit quality on the financing decision incurred by Indonesia manufacturing listed companies. By using secondary data; corporate governance measured with the index of CG issued by IICG. and audit quality measured by theusing of Big 4 public accounting firm in Indonesia . The data was analyzed under multiple linear regression analysis by SPSS v.18. The empirical findings reveal that corporate governance anda audit quality have no significant impact to Financial decision of the firm.
Keywords: Corporate governance, Audit quality, Financing decision, Indonesia manufacturing listed companies.

1. Introduction

The financing decision can be defined as the way of choosing a company's financing resources, namely choosing both the available resources and their mix in order to obtain the major objective in finance, i.e. the maximization of shareholders' wealth. The companies' financing decision is one of the most debated fields of the corporate finance theory. In taking financing decisions, a company's management uses efficiency financial criteria, such as the financing duration and the autonomy provided by certain financing sources. The theoretical models on which it is based are subject to continuous improvement and the financing theories' application at company level is limited. The identification of the optimum capital structure should take into account the analysis of financing policy determinants: the opportunity cost of capital, the tax policy, the agency costs etc. The selection consists in choosing between equity and borrowed funds. Despite these criteria, the most important element determining the financing decision and the financial structure is represented by the cost of providing these resources. The management targets the reduction, and even the minimization, of the cost of capital. From a methodological point of view, the cost of capital is an average weighted cost of the different financing resources of a company.

As a result of establishing a certain capital structure, borrowing funds influences, within certain limits, the performance and the value of an enterprise. At the same time, the reduction of the cost of capital is also achieved, given the fact that borrowed funds are less costly than the external equity funds. The Modigliani-Miller model sustains the impact of the borrowing policy on the equity cost of capital, in the sense that increasing the longterm financial debt leads to the increase of financial leverage, which will determine the increase of the return on equity, given an economic profitability higher than the interest rate.(Modigliani and Miller, 1958). This is the financial leverage effect. If the model accepts the existence of the tax on profit, then levered enterprises will have an advantage over those unlevered (that haven't borrowed funds), due to the tax savings generated by the tax deduction of interest. These fiscal savings increase the net profit of the indebted enterprise. The interest paid by the levered company to the creditors represents the interest after taxation, while the difference is borne by the state, which will receive a diminished profit tax in its budget (Modigliani and Miller, 1963).

The agency theory has brought substantial improvement in the theoretical field. According to this theory, the enterprise is no longer addressed only from the perspective of shareholders and their wealth maximization, as the theory tries to offer solutions for harmonizing the stakeholders' interests. In performing their activity, the decision makers of a company will have to take into account the conflicts that arise from bringing together several interests. If these conflicts are not recognized and properly regulated, they can jeopardize the efficiency and lead to the reduction of the company's market value. As a natural consequence, the conflicts of interest generate agency costs (Jensen and Meckling, 1976). The Jensen-Meckling model illustrates that the agency costs can be reduced through leverage. According to an overview from the literature in the field, the agency costs are defined as those costs borne to motivate the entrusted managers to maximize the shareholders' wealth instead of acting in their own benefit. The most important conflict of interests, from the point of view of the impact on corporate value and performance, is the one between the owners and the managers of the company. The agency theory sustains the manager is not concerned only with maximizing the owners' wealth, given the fact that he has his own utility function to maximize. Consequently, the influence on corporate performance and value, as well as the impact of leverage on the reduction of agency costs, both support the idea that the financing method is correlated to the organization of the business, with specific relations between the different persons implicated in the business, i.e. concerning the management or the corporate governance.

The concept of corporate governance refers to the coordination of the interests of different stakeholders of the enterprise: the shareholders, the managers, the employees, the creditors, the clients, the suppliers, the state etc. In every enterprise, there is an assembly of specific relationships between the physical or juridical persons that have a stake in the business. Corporate governance mechanisms are generally not limited to internal control. In fact, external auditor represents the most important external control mechanism. The studies concerning corporate governance focus on the way in which the suppliers of corporate capital make sure that their investments bring them benefit. The evidence that debt can serve as an instrument to discipline managers to avoid the inefficient consumption of a company' resources is vital for the literature regarding corporate finance. A high number of well-known analysts have developed this evidence. Moreover, the managers themselves sometimes choose, on a voluntary basis , the debt instruments to limit their own plans and financial constructions, thus trying to prevent changes in corporate control. Due to this finding and in order to support the idea that both leverage and well designed corporate governance structures represent solutions for reducing agency problems, we would expect the companies in which the corporate governance mechanism functions properly to have a lower debt ratio.

Myers and Majluf (1984) explain how adverse selection can lead companies to refuse to issue equity and forgot profitable projects. A company's financial statements play a critical role in reducing this asymmetry, and their integrity is essential to well-functioning capital markets. In turn, auditors play a key role in assuring the integrity of information. Yet, all auditors may not offer the same level of service. While the services of larger auditors (the Big 6 firms, in particular) are more expensive (as shown, for example, by Ireland and Lennox 2002), these firms are usually thought to offer a higher level of audit quality. Willenborg (1999) states that it is widely perceived that larger, more prestigious firms have greater incentives not to perform a low-quality audit at a high-quality price. This higher quality should reduce the information asymmetry between informed managers and uninformed suppliers of capital and thus affect a company's financing decisions. One way to determine the quality of corporate governance (CG) by using CG index. CG Index is an assessment of the application of the CG is in a company that measure aspects of CG specified. In a previous study, Jiraporn (2012) on research using metrics governance of Institutional Shareholders Services (ISS) found evidence that the company's capital structure is influenced by the quality of CG and CG bad will result in higher leverage levels. In addition to using CG index, another measure is to use a board size and also the proportion of outside directors. Good board size and the proportion of outside directors is believed to provide better oversight on the performance of companies that will have an influence on funding decisions of the company. In a previous study, Thus with the number of independent board that more are expected to have a negative effect on leverage.

Research Chang et al. (2009) found evidence that the level of debt ratio of the company being audited by the "Big Six" is lower than the companies audited by non-Big Six. That is because companies audited by the auditors of the big six have a lower information asymmetry. Auditor brand name like the big six or big four, has described much of the literature, will provide audit services better than other auditors because they have the ability to better monitoring. Another study conducted by Mansi et al. (2004) showed a significant effect of audit quality on the quality of financial information provided to investors. Thus, the quality audit is one of the main factors affecting the credibility of financial information.

2. Theoritical Framework and Hypotheses

2.1. Corporate governance effects to financial decision

The concept of corporate governance refers to the coordination of the interests of different stakeholders of the enterprise: the shareholders, the managers, the employees, the creditors, the clients, the suppliers, the state etc. In every enterprise, there is an assembly of specific relationships between the physical or juridical persons that have a stake in the business. The evidence that debt can serve as an instrument to discipline managers to avoid the inefficient consumption of a company' resources is vital for the literature regarding corporate finance. A high number of well-known analysts have developed this evidence. Moreover, the managers themselves sometimes choose, on a voluntary basis, the debt instruments to limit their own plans and financial constructions, thus trying to prevent changes in corporate control. Due to this finding and in order to support the idea that both leverage and well designed corporate governance structures represent solutions for reducing agency problems, we would expect the companies in which the corporate governance mechanism functions properly to have a lower debt ratio. In this respect, the results of the studies in the field confirm the idea according to which the progresses in the corporate governance area limit the role of debt as a disciplinary mechanism, as the analyzed companies have significantly diminished their leverage (Arping and Sautner, 2010).

CG basic principle has provided a reference for the realization of a system of good governance in a company. The principle of transparency and accountability to explain that the company should be able to provide information in a transparent manner and be responsible for the work done. This principle requires companies, especially from the management to provide information, especially information in the financial statements with the truth, so that would make the information in the financial statements is relevant and trustworthy.Thus the

reliability of the financial statements have a very important role as the financial statements is the liaison between investors and companies. To realize reliable financial statements, from the internal side of the company can be supported from the implementation of GCG. In its application, the CG will use the company's organs such as commissioners to supervise the performance of the company's management. With supervision, it is hoped that existing processes and procedures can be regulated and controlled properly. This will greatly contribute to suppress the information asymmetry that may occur. Kayhan and Titman (2007) in their research proved that the better CG of a company, the lower the level of information asymmetry faced by users of information produced by the company. Information asymmetry is the impact of agency problem and one of the mechanisms to minimize agency problems is to implement GCG. GCG is expected to reduce the information asymmetry in the financial statements of companies that report presented more reliable by its users.

There are several components that can be used to measure of the GCG, such as by using CG index, the size of the board, and the proportion of outside directors. CG index is usually a measurement conducted by an independent body of the company to find out how well the application of CG at the company. In a previous study, Jiraporn (2012) conducted a study to determine how much influence the CG on the capital structure using data governance metrics from Institutional Shareholder Services (ISS), the results of the study proved that the company's capital structure is influenced by the quality of CG and CG bad will resulting in higher leverage levels.

Furthermore, this study will also test the sensitivity of the measurement variable other CG that board size and the proportion of outside directors. Board size is the number of commissioners in a company. The more the number of commissioners in the company, will provide oversight functions and better control in the company to achieve its goals, so it will create a system of governance that is good also to have a positive impact to press agency problems and information asymmetries that ultimately affect the structure the company's capital. The previous study conducted by Pittman, and Fortin (2004) found evidence of a significant effect of several variables CG towards the funding structure. Results from these studies is that there is a significant negative effect on the size of the board of the debt ratio. According Pittman and Fortin where the creditor / debt becomes a substitute mechanism on weak CG companies, companies that have a smaller board size tend to use debt to suppress the agency problem that exists.

The next component to measure the CG is to use a proportion of outside directors. Outside the board of directors is not directly related to the operations of the company and has the task of overseeing the company's business activities, which is expected to help reduce conflicts between shareholders and company management. La Porta et al. (1997) show that countries that protect shareholders have more valuable stock markets, larger numbers of listed securities per capita, and a higher rate of IPO (initial public o!ering) activity than do the unprotective countries. Countries that protect creditors better have larger credit markets. Several recent studies have also established a link between investor protection, insider ownership of cash flows, and corporate valuation. Gorton and Schmid (2000) show that higher ownership by the large shareholders is associated with higher valuation of corporate assets in Germany. Claessens et al. (1999) use a sample of East Asian "rms to show that greater insider cash flow ownership is associated with higher valuation of corporate assets, whereas greater insider control of voting rights is associated with lower valuation of corporate assets.

2.2. Audits quality effect to corporate's funding decision

Audit is a key contributor to financial stability and to re-establish trust and market confidence. Auditors are entrusted by law with conducting statutory audits and fulfill an important role in offering an opinion on whether the financial statements are stated truly and fairly (Quick, 2012). According to Duff (2004), audit quality consists of technical and service quality (the degree of customers' satisfaction and meeting their requirements). Technical quality involves capability, reputation capital, expertise, scales of independence and experience, while quality of service is defined by empathy responsiveness, and the supply of client services andnon-audit services. It is challenging and complicated to measure audit quality (K. L. Jensen & Payne, 2005; Niemi, 2004; Wooten, 2003). Nevertheless, according to Bailey and Grambling (2005),Francis (2004) and PCAOB (2008); there are several possible measurements of audit quality available in practice and in the literature. This set of researches includes two parts. The first group of researches using direct measures like: financial reporting compliance with GAAP, bankruptcy, quality control review, desk review and SEC performance are used as a measure of audit quality (Chadegani, 2011). In the second studies, indirect measureslike: auditor tenure, industry expertise, audit fees, economic dependence, audit size, reputation and cost of capital are used as a measure for audit quality (Chadegani, 2011).

According to Wallace (1980), claims that shareholders demand audited fiscal reports as these reports offer details that are beneficial for their decisions on investments; hence, the external audit would act as a tracking device that decreases managers' interests in misstating the earnings. Thus, the audit is used as a method of enhancing the top quality of the fiscal information; hence, it is expected that a better audit quality will be linked with reduced cost of capital by companies. Shareholders depend on the external auditor to offer some

guarantee that the fiscal reports of a company are not deceiving. It is critical that the tracking mechanism offered by the external auditors is not affected and becomes the most essential aspect for the proper delivery of an independent auditing function.

Kim et al. (2011) studied private Korean firms as their sample for a duration of 16 years from 1987 to 2002 including 1997 which was the year of the Asian financial crisis. It was found that private firms that had carried out voluntary audits paid comparatively reduced interest rates for their debt compared to private firms that had not carried out audits. It was revealed that the hiring of Big 4 auditors does not cause more decrease in the interest cost of borrowing, in comparison with the hiring of non–Big 4 auditors. Causholli and Knechel(2012) investigated the setting where a high audit quality lowers a company's cost of debt. It was discovered that young companies at the IPO time paid higher interest rates and auditor quality played a huge difference in reducing the financing's cost of debt. Huguet and Gandía(2012) investigated the link between the costs of debt capital and auditing within the SME framework, a subject not studied much in previous literature and that yielded contradictory results. They used Spanish SMEs as the sample for the study, which contained audited firms, with voluntary and mandatory audits, and non-audited firms. It was discovered that auditing assisted in lowering the cost of debt for SMEs, but only for firms that were more than a particular size. In addition, it was discovered that for bigger SMEs, the auditing had a lesser effect on the cost of debt as the size increased. SMEs audited by the Big 4 auditors were not found to have a reduced cost of debt compared to those audited by non-Big 4 auditors.

Li et al (2010) investigated the link between specialist auditors in the industry and the cost of debt financing by utilizing a city and national level industry specialist guideline. In line with the assumption that higher audit quality is linked to a reduced information risk, which is good for clients in getting debt capital, it was found that companies audited by the auditors from the city level industry specialist, either jointly or individually with auditors from the national level industry specialist, experienced a major reduction in the cost of debt financing as calculated by bond spread and credit rating. In Indonesia case, result study by Wahyuni(2013), the data used are 789 firms of observation years during 2000-2010. From this amount, 291 samples are high profile industry. Consistent with expectation, the results of this study find that thereis relationship between auditor specialization and the cost of debt financing is most pronounced in a high profile industry.

3. Research Methodology

The population in this study is the automotive company and the components listed in the Indonesia Stock Exchange in 2010-2013. List of automotive companies and the following components of financial statements and annual report in 2010-2013 that are downloaded from the official website of Indonesia Stock Exchange is www.idx.co.id. The reason for choosing the company autos and parts as the research object was to see how much it had taken keputusanpendanaan automotive and components in Indonesia.

There are 10 companies of automotive and components with a total population of 40 data. Sampling was done by purposive sampling based on the criteria specified. The population in this study is a manufacturing company specializing in automobile and components and has been in operation and listed on the Indonesia Stock Exchange (IDX) since the beginning of 2010 until the end of 2013. This study used 10 companies as a population study, while the code and the name of the company as following :

No	Code	List of the company
1	ASII	Astra International Tbk
2	AUTO	Astra Otoparts Tbk
3	BRAM	Indo Kordsa Tbk
4	GDYR	Goodyear Indonesia Tbk
5	GJTL	Gajah Tunggal Tbk
6	INDS	Indospring Tbk
7	MASA	Multistrada Arah Sarana Tbk
8	NIPS	Nippres Tbk
9	PRAS	Prima Alloy Steel Universal Tbk
10	SMSM	Selamat Sempurna tbk

The sample in this study is a listed company on the Stock Exchange from the period 2010 to 2013. The sample period of research used in this study is Non-Probability Sampling, with purposive sampling technique, the sampling is not random and samples taken by certain criteria. Sample selection criteria are:

a. The manufacturing company has been operating and is listed on the Indonesia Stock Exchange (IDX) since the beginning of 2010 until the end of 2013

b. Manufacturing companies that have had a complete financial data in accordance with the needs of research.

c. Manufacturing companies that have had a value of CG index measurement performed by IICD.

The collection of the data obtained from literature review in accordance with this research and also

through the website. Collecting reading materials, articles, and other resources from previous research to get the literature that have relevance to the issues to be studied.Collecting secondary data needed in the research process, data related to financial statements obtained from the website IDX (www.idx.co.id), IDX database Public Financial Report Information System, and the Indonesian Capital Market Directory (ICMD). As for the acquisition of data related to the CG index derived from the Indonesian Institute for Corporate Directorship (IICD). Perform statistical testing of secondary data that has been obtained so that it can answer the questions and the research hypothesis.

Corporate Governance, CG index is a measurement of the quality of the CG companies in Indonesia are carried out by the IICD (Indonesian Institute for Corporate Directorship). The CG index measurement using the OECD principle as a benchmark that includes the rights of shareholders, which is equivalent to the treatment of shareholders, role of stakeholders, disclosure and transparency, and the responsibility of the board. The fifth such instrument will be described comprehensively in 117 questions (Appendix 7), then these questions, IICD implementing GCG classifying issuers into four categories, namely outstanding with the implementation of GCG reach 90-100 percent, good (80-89 per cent), fair (60-79 percent), and poor (less than 60 percent). Good CG practices are increasingly expected to reduce the degree of information asymmetry faced by investors. This will suppress the required rate of return investors, and ultimately lower the cost of capital faced by the company. The capital costs are lower overall opportunities of companies issuing financial instruments which are more at risk, in this case the shares. In addition, high quality CG also can reduce the need for the presence of supervision by creditors. Therefore, the quality of CG expected to negatively affect the company's leverage. In previous studies, Jiraporn (2012) has conducted research using CG index issued by ISS (Institutional Shareholder Services) and get the result that the low quality CG in a company will reflect the higher leverage level. Jiraporn (2012) showed that the quality of the CG has a material effect on the company's decision as one of them is the funding decision.

The audit quality in this study will use the classification of Big-4 and Non Big-4. This measurement is a measurement used by Chang et al. (2009) to determine the effect of audit quality on funding decisions. This study will use a dummy variable that is 1 (if the company is audited by KAP Big-4) and 0 (if the company is audited by KAP Non Big-4). The use of firm size to measure the quality of the audit has been presented by Watts and Zimmerman (1981). Lennox (2000) revealed a positive relationship between the quality of the audit with firm size. KAP large provide better audit quality to maintain its reputation in the public eye.

Good audit quality is expected to reduce the degree of information asymmetry faced by investors. This will suppress the required rate of return investors, and ultimately lower the cost of capital faced by the company. The capital costs are lower overall opportunities of companies issuing financial instruments which are more at risk, in this case the shares. In addition, high quality audits can also reduce the need for the presence of supervision by creditors. Therefore, the quality of audits expected negative effect on corporate financing decisions. As the table below the name of Big 4 public accounting firm in Indonesia.

Big Four	Partner firm in Indonesia
Price WaterhouseCoopers	Tanudiredja, Wibisana & Rekan
Ernst & Young	Purwantono, Suherman & Surja
Delloite	Osman Bing Satrio & Rekan
KPMG	Siddharta & Widjaja

Financing decision, a decision that concerns about the shape and composition of funding used by the enterprise (Suad, 1995). Brealey, Myers & Marcus (2001: 446) states financing decision is the form and amount of funding or financing of an investment company. The funding decision with regard to the process of selecting the source of funds used to finance planned investments of various alternative sources of funds available, in order to obtain a combination of the most efficient expenditure (Sudana, 2009: 5).

4. Discussion and future studies

Descriptive statistical analysis used to determine the description of the data, this analysis is done by looking at the maximum, minimum, mean, and standard deviation of the data. Descriptive analysis using SPSS 18, based on table 4.1, an unknown number of samples (N) 40 corporate data, the variables studied are the Corporate Governance and Quality Audit of Funding Decisions. The test results of descriptive statistical analysis can be seen in the following table:

Table 4.1 The test results of descriptive statistics

	N	Minimum	Maximum	Mean	Std. Deviation
GCG(X1)	40	.2500	.5000	.360777	.0520359
UDD(X2)	40	3.0000	11.0000	5.725000	2.4493589
KOA(X3)	40	1.0000	1.0000	1.000000	.0000000
KUA(X4)	40	.0000	1.0000	.625000	.4902903
DTA(Y)	40	.2020	.7099	.485119	.1445966
Valid N (listwise)	40				

F test is used to determine the effect of independent variables simultaneously to the independent variable, whether the impact is significant or not. When the value of F count is greater than the value of F table, then Ho is rejected and accepted Ha and if the significance value <0.05, Ha accepted. F statistical test results in this study are shown in the table below :

Table 4.2 F statistical test results (*F-Test*)
ANOVAb

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	.086	3	.029	1.424	.252
	Residual	.729	36	.020		
	Total	.815	39			

a. Predictors : (Constant), KUA(X4), GCG(X1), UDD(X2)
b. Dependent Variable : DTA(Y)

This test aims to determine the effect of each independent variable partially on dependen.Jika variable significance value <0.05 it means that the independent variables have an effect on the dependent variable, but if the significance value ≥ 0.05, meaning that the independent variable has no influence on the dependent variable. The test results of the t test values and hasilsignifikansi testing on the following table:

Table 3 : Results of the t test
Coefficientsa

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	.778	.172		4.526	.000
	GCG(X1)	-.698	.507	-.251	-1.375	.178
	UDD(X2)	-.007	.013	-.112	-.519	.607
	KUA(X4)	-.005	.067	-.018	-.080	.937

a. Dependent Variable : DTA(Y)

a.Based on calculations using the t test, that the variables of Corporate Governance and Audit Quality has no effect on the company's Funding Decisions Automotive and Parts Manufacturing based listed in Indonesia Stock Exchange period 2010 - 2013. In general, the results of the analysis above can be explained as follows:

Summary of hyphoteses testing results

Code	hyphoteses testing	Summary
H1	Corporate Governance (CG) practices influence the funding decisions of companies	Reject
H2	Quality of audits influence to the corporate funding decision	Reject

T test results showed variable GCG has a t-count value of -1.375 while the t-table is 1.684 so that t <t-table (-1.375 <1.684). A significance value of 0.178> value of alpha (α = 0.05). From these results, then Ho is accepted and Ha rejected, meaning that corporate governance does not significantly influence the funding decisions of the company. This is because no matter how much the board of commissioners and board of directors in a company as well as existing or not the audit committee of a company has not been able to determine a funding decision the company can run smoothly, because a funding decision can be said to be a good walk or lancer if a company they will get benefit from good sales in the form of cash or credit. The test results of H1 shows that corporate governance does not significantly influence the funding decisions of the company. The results of this study are consistent with Hafiz Primary Sales (2012) which states that good corporate governance does not significantly influence the funding decisions of the company. Influence the quality of audits of corporate funding decision.

This is because no matter how much the board of commissioners and board of directors in a company as well as existing or not the audit committee of a company has not been able to determine a funding decision the company can run smoothly, because a funding decision can be said to go well or smoothly if a company is

getting benefit from good sales in the form of cash or credit. A company can say their funding decisions better if the company had been audited properly. Moreover, audited by a public accounting firm that includes KAP Big 4. But all this was not a very important factor in making funding decisions went well, because not all companies that have been in big 4 audit KAP has good funding decisions. So it is indeed a good funding decisions can be done by adding a cash income or fund the company through the sale of goods that produced the company either on credit or cash.

The test results of H2 indicates that audit quality is not significantly influence the funding decisions of the company.

Based on the results of the discussion and testing that has been done before, then the conclusion can be made as follows: Corporate Governance (CG) and audit quality did not significantly influence the funding decisions of companies in automotive and component companies listed on the Indonesia Stock Exchange. Suggest for further research could use more companies from others sectors more diverse as the study sample, the research results to be more representative, because the sample used in this study only company manufacturing automotive sector and the components listed in the Indonesia Stock Exchange.More independent variables may effect to financing decisions because in this study only used two independent variables.

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