The Impact of Audit Quality, Auditor Reputation, and Auditor Rotation on the Market Value of Companies on the Indonesia Stock Exchange

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Article Info	ABSTRACT
	This study investigates the effects of audit quality, auditor reputation, and auditor rotation on the market value of companies listed on the Indonesia Stock Exchange. Using a quantitative approach, the research analyzed data from 150 companies, collected through structured questionnaires and audited financial reports. The relationships among variables were tested using Structural Equation modeling least Squares (SEM-PLS 3). The results show that audit quality, auditor reputation, and auditor rotation significantly and positively influence market value, with audit quality having the strongest effect. These findings highlight the critical role of robust auditing practices in enhancing investor confidence and corporate valuation. Practical recommendations for companies, auditors, and regulators are provided to strengthen the financial reporting ecosystem and ensure sustainable market growth.

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1. INTRODUCTION

The capital market plays a crucial role in economic growth by enabling companies to raise funds and allowing investors to allocate resources efficiently. The market value of companies, a key indicator of investor confidence and corporate performance, is influenced by operational efficiency, financial performance, and corporate governance. Capital market efficiency contributes significantly to economic growth by optimizing resource allocation. In Bangladesh, high market capitalization and robust liquidity drive economic growth, attracting both domestic and foreign investments [1]. In Nigeria, capital market performance links to economic growth, with market capitalization showing positive but insignificant effects, highlighting the need for transparency and fair trading to restore market confidence [2], [3]. External auditing enhances the reliability and transparency of financial statements, critical for informed investor decision-making, and influences corporate governance practices [4]. However, challenges such as market inefficiencies and governance gaps remain. Tools like the Financial Market Efficiency Index can address these issues and support better stakeholder decision-making [5].

Audit quality is fundamental to corporate governance, ensuring financial reports are accurate, comply with regulations, and build investor trust, ultimately enhancing market value. High-quality audits depend on auditor competence, independence, and adherence to ethical standards, which collectively ensure reliable financial disclosures. Competence, encompassing knowledge, experience, and skills, is vital for effective audits, while independence safeguards against biases and conflicts of interest [6], [7]. Ethical behavior and professional care further reinforce public trust and accurate reporting [6], [7]. The reputation of audit firms, particularly the Big-5, correlates with superior audit quality due to their resources, expertise, and stringent quality control measures [8]. Auditor rotation is a regulatory measure to maintain independence by reducing familiarity threats from long-term engagements, though it risks limiting auditors' understanding of client operations if tenures are too short [8], [9]. High audit quality, supported by competent and independent auditors, bolsters stakeholder confidence in financial reports, reinforcing effective corporate governance [10]. While auditor rotation promotes independence, balancing it with adequate time to comprehend client businesses ensures comprehensive audits [8].

In Indonesia, regulatory frameworks such as those mandated by the Financial Services Authority (Otoritas Jasa Keuangan) have emphasized the importance of auditing practices to align with global standards. However, the interplay between audit quality, auditor reputation, and auditor rotation in influencing market value remains underexplored in the context of the Indonesia Stock Exchange (IDX). This research aims to address this gap by investigating the effects of these variables on the market value of publicly listed companies in Indonesia.

2. LITERATURE REVIEW

2.1 Audit Quality

Audit quality is a critical component of corporate governance, ensuring the reliability and accuracy of financial statements while reducing information asymmetry and mitigating agency problems between management and stakeholders. Defined by [11] as the likelihood that an auditor will both discover and report material misstatements, audit quality is influenced by auditor independence, technical competence, and adherence to auditing standards. Empirical evidence highlights that high audit quality enhances investor confidence, contributing to increased company market value [6], [7], [12]; for instance, [8] found that companies with high-quality audits demonstrate lower earnings management, thereby boosting market credibility. In Indonesia, the Financial Services Authority (Otoritas Jasa Keuangan) emphasizes the importance of audit quality in maintaining the integrity of financial reporting, reflecting its pivotal role in fostering trust and transparency.

2.2 Auditor Reputation

Auditor reputation significantly influences stakeholders' perceptions of a company's financial disclosures, serving as a critical indicator of reliability, particularly in markets with diverse levels of corporate governance like Indonesia. Reputable auditors, especially those from large firms such as the Big Four, are associated with higher audit quality due to their professionalism, technical expertise, and adherence to ethical standards. Research in Indonesia demonstrates that auditor reputation positively impacts audit quality by improving financial reporting and reducing earnings management, particularly in companies audited by Big Four firms [13], [14]. Similarly, in Vietnam, firms audited by the Big Four exhibit improved financial reporting quality and significant reductions in real earnings management, alongside a decrease in audit report lag, reflecting more efficient and timely disclosures [15]. The professionalism, competence, and ethics of auditors are essential components of audit

quality, reinforcing public trust and ensuring reliable financial disclosures [16], [17].

2.3 Auditor Rotation

Mandatory auditor rotation is a regulatory mechanism aimed at enhancing auditor independence and improving audit quality by periodically replacing auditors to prevent excessive familiarity with clients, which could compromise objectivity. Research highlights the "fresh-look effect" of audit firm rotation, where significant changes in key audit matters enhance audit quality by addressing institutional pressures for standardization [18]. Similarly, the new-look effect from audit partner rotation is valued by bond market investors, as reflected in a decrease in the ex-ante annual bond yield spread, indicating improved audit quality and reduced information asymmetry [19]. Auditor rotation reduces threats to independence, such as familiarity and financial dependence, fostering professional skepticism and integrity in financial reporting [20]. It serves as a strategy to maintain independence and impartiality, which are critical for unbiased financial statements [21]. However, mandatory rotation can introduce inefficiencies due to auditors' initial lack of understanding of client operations, potentially impacting audit quality negatively [22]. The effectiveness of rotation policies also depends on the expertise of the incoming auditor and the firm's size, with Big 6 firms typically better positioned to manage rotation costs and ensure audit sustainability [19].

2.4 Market Value

The relationship between audit practices and market value is well established, with high-quality audits and reputable auditors enhancing the credibility of financial disclosures, positively impacting market value. Companies with auditors from the Big 4 often experience more favorable market reactions to earnings announcements, reflecting the value investors place on credible financial reporting [23]. Audit quality also moderates the impact of good corporate governance on firm value, amplifying the positive effects of governance practices [24]. Effective corporate governance, including independent audit committees, is linked to higher market valuations as such structures ensure reliable financial reporting, which investors highly value [25]. Auditor independence, bolstered by mechanisms like mandatory rotation and limits on non-audit services, further enhances trust and credibility [26]. Additionally, audit committee effectiveness, characterized by frequent meetings and financial expertise, significantly correlates with stronger market reactions to earnings announcements, emphasizing their role in strengthening the perceived quality of financial reporting [25].

2.5 Theoretical Framework

This study is grounded in the Agency Theory, which highlights the conflict of interest between management (agents) and shareholders (principals). Auditing serves as a monitoring mechanism to align the interests of both parties by ensuring the accuracy of financial disclosures. Additionally, the Signaling Theory underpins the relationship between auditor reputation and market value, suggesting that reputable auditors signal credibility and reliability to investors. The study also draws on the Resource-Based View (RBV), emphasizing the strategic importance of high-quality audits as a resource that provides a competitive advantage.

Based on the literature review, the following hypotheses are proposed:

H1: Audit quality has a positive and significant effect on the market value of companies.

H2: Auditor reputation has a positive and significant effect on the market value of companies.

H3: Auditor rotation has a significant effect on the market value of companies.
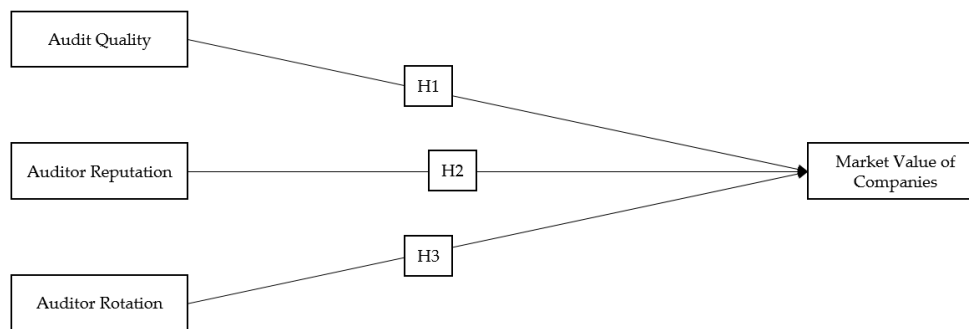
Figure 1. Theoretical Framework

3. METHODS

3.1 Research Design

This study employs a quantitative research design to analyze the relationships between audit quality, auditor reputation, auditor rotation, and the market value of companies listed on the Indonesia Stock Exchange (IDX). The research focuses on a population of all companies listed on the IDX, from which a purposive sample of 150 companies was selected based on specific criteria: companies listed on the IDX for at least three consecutive years, those providing publicly available audited financial reports, and those that had undergone at least one auditor rotation during the observation period. Data collection involved both primary and secondary sources. Primary data were gathered through structured questionnaires distributed to finance managers, auditors, and other relevant stakeholders in the selected companies, using a Likert scale (1 = strongly disagree to 5 = strongly agree) to measure perceptions of audit quality, auditor reputation, and the impact of auditor rotation. Secondary data were obtained from audited financial reports and market performance data published on the IDX website, ensuring a comprehensive approach to testing the proposed hypotheses.

3.2 Data Analysis Technique

The study employs Structural Equation Modeling-Partial Least Squares (SEM-PLS 3) for data analysis, a method well-suited for examining complex relationships between latent variables and providing robust results even with relatively small sample sizes. The analysis follows a structured process, beginning with the evaluation of the outer model, which includes validity testing using factor loading and Average Variance Extracted (AVE) to confirm the reliability of the measurement model, and reliability testing using Cronbach's alpha and composite reliability to assess internal consistency. The inner model evaluation involves examining path coefficients to determine the significance of relationships between variables and assessing the coefficient of determination (R^2) to measure the model's predictive power. Finally, hypothesis testing is conducted using t-statistics and p-values, with a p-value of less than 0.05 indicating statistical significance.

4. RESULTS AND DISCUSSION

4.1 Descriptive Statistics

The study analyzed responses from 150 companies listed on the Indonesia Stock Exchange (IDX). Descriptive statistics were calculated to summarize the data for each variable. The mean scores for audit quality, auditor reputation, and auditor rotation were 4.12, 4.25, and 3.85 respectively, indicating generally positive perceptions of these variables among the respondents. The market value had a mean score of 4.08, suggesting that the sampled companies maintain relatively strong market positions.

The study analyzed data from 150 companies listed on the Indonesia Stock Exchange (IDX), focusing on demographic characteristics such as industry sector, company age, auditor type, and auditor rotation frequency. The sample included companies from diverse industry sectors, with the majority representing Consumer Goods (26.7%), Financial Services (20.0%), and Manufacturing (16.7%), ensuring broad

representativeness across industries. Regarding company age, 33.3% of the firms had been listed for 11–20 years, 30.0% for 5–10 years, 23.3% for more than 20 years, and 13.3% for less than 5 years. In terms of auditor type, 56.7% of the companies utilized "Big Four" auditors, while 43.3% engaged non-"Big Four" auditors. The frequency of auditor rotation over the past five years revealed that 33.3% of companies had no rotations, 40.0% rotated once, 20.0% rotated twice, and 6.7% rotated more than twice. These characteristics provide a comprehensive overview of the sample's diversity and relevance to the research objectives.

4.2 Measurement Model Evaluation

The measurement model was evaluated using several criteria, including loading factors, Cronbach's alpha (CA), Composite Reliability (CR), and Average Variance Extracted (AVE). These measures assess the reliability and validity of the constructs used in the study.

Table 1. Validity and Reliability

Variable	Code	Loading Factor	CA	CR	AVE
Audit Quality	AQ.1	0.806	0.901	0.925	0.673
	AQ.2	0.895			
	AQ.3	0.886			
	AQ.4	0.831			
	AQ.5	0.737			
	AQ.6	0.754			
Auditor Reputation	Are.1	0.865	0.775	0.868	0.686
	Are.2	0.817			
	Are.3	0.803			
Auditor Rotation	Aro.1	0.934	0.829	0.921	0.854
	Aro.2	0.914			
Market Value of Companies	MVC.1	0.888	0.898	0.929	0.766
	MVC.2	0.832			
	MVC.3	0.891			
	MVC.4	0.887			

The study evaluated measurement reliability and validity through outer loading factors, internal consistency reliability, and convergent validity. Outer loading factors, which assess the correlation between observed indicators and their latent variables, revealed strong reliability, with all indicators exceeding the acceptable threshold of 0.70. Audit Quality (AQ) indicators ranged from 0.737 to 0.895, Auditor Reputation (Are) from 0.803 to 0.865, Auditor Rotation (Aro) at 0.914 and 0.934, and Market Value of Companies (MVC) between 0.832 and 0.891. Internal consistency reliability, measured by Cronbach's Alpha (CA) and Composite Reliability (CR), showed all constructs exceeding the 0.70 threshold, with AQ achieving CA = 0.901 and CR = 0.925, Are with CA = 0.775 and CR = 0.868, Aro at CA = 0.829 and CR = 0.921, and MVC with CA = 0.898 and CR = 0.929, indicating strong reliability. Convergent validity, assessed via Average Variance Extracted (AVE), demonstrated all constructs meeting or exceeding the 0.50

threshold, with AQ at 0.673, Are at 0.686, Aro at 0.854, and MVC at 0.766, confirming that the constructs explain more than half the variance in their indicators and ensuring robust measurement validity.

4.3 Discriminant Validity

Discriminant validity evaluates the extent to which a construct is distinct from other constructs within the model. It ensures that each construct measures a unique aspect of the model and that indicators are more strongly related to their own construct than to others. The Fornell-Larcker Criterion was used to assess discriminant validity, which compares the square root of the Average Variance Extracted (AVE) for each construct to the correlations with other constructs.

Table 2. Discriminant Validity

	Audit Quality	Auditor Reputation	Auditor Rotation	Market Value of Companies
Audit Quality	0.820			
Auditor Reputation	0.813	0.829		
Auditor Rotation	0.652	0.708	0.824	
Market Value of Companies	0.751	0.742	0.700	0.875

The study confirmed discriminant validity by demonstrating that the square root of the Average Variance Extracted (AVE) for each construct is greater than its correlation with any other construct. For instance, the square root of the AVE for Audit Quality (0.820) is higher than its correlations with Auditor Reputation (0.813), Auditor Rotation (0.652), and Market Value of Companies (0.751). Similarly, the square root of the AVE for Market Value of Companies (0.875) exceeds its correlations with Audit Quality (0.751), Auditor Reputation (0.742), and Auditor Rotation (0.700). These results indicate that each construct is more closely related to its own indicators than to other constructs, confirming strong discriminant validity.
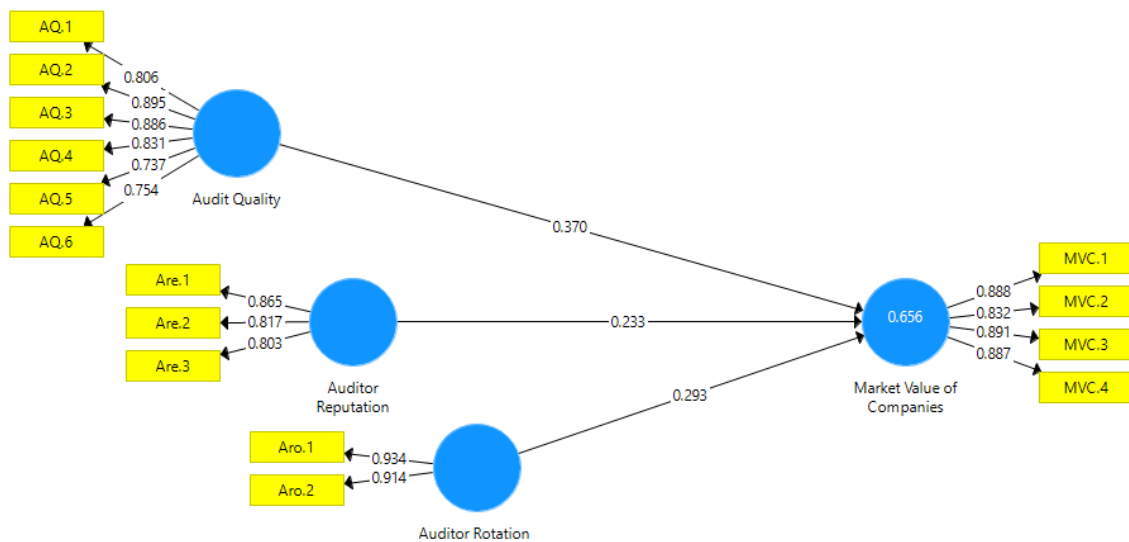

Figure 2. Internal Model

Table 3. R Square

	R Square	R Square Adjusted
Market Value of Companies	0.656	0.647

The R Square (R²) and R Square Adjusted values assess the explanatory power of the model, measuring the proportion of variance in the dependent variable (Market Value of Companies) explained by the independent variables (Audit Quality, Auditor Reputation, and Auditor Rotation). The R² value of 0.656 indicates that 65.6% of the variance in the Market Value of Companies is accounted for by the combined effects of the independent variables, demonstrating substantial explanatory power. The R Square Adjusted value of 0.647, which adjusts for the number of predictors and sample size, shows a slight decrease from R², reflecting a minor adjustment for model complexity while maintaining a high level of robustness. Model fit was further validated through various indices, including the Standardized Root Mean Square Residual (SRMR), d_ULS, d_G, Chi-Square, and Normed Fit Index (NFI), evaluated for both the Saturated Model (fully connected) and the Estimated Model (tested model), ensuring the hypothesized model aligns well with the observed data.

Table 4. Model Fit

	Saturated Model	Estimated Model
SRMR	0.097	0.097
d_ULS	1.118	1.118
d_G	0.556	0.556
Chi-Square	390.600	390.600
NFI	0.741	0.741

The model's fit was assessed using several indices, each providing insights into its alignment with the observed data. The Standardized Root Mean Square Residual (SRMR) value of 0.097 for both the Saturated and Estimated models indicates an acceptable model fit, being close to the threshold of 0.10. The d_ULS (Unweighted Least Squares Discrepancy) value of 1.118 suggests an adequate fit, reflecting a low discrepancy between the empirical and model-implied covariance matrices. Similarly, the d_G (Geodesic Discrepancy) value of 0.556 demonstrates a good fit. The Chi-Square value of 390.600, while influenced by sample size, indicates a reasonable model fit given the complexity of the model. However, the Normed Fit Index (NFI) value of 0.741, though indicating moderate fit, falls below the recommended threshold of 0.90, suggesting potential areas for improvement. Collectively, these indices validate that the model fits the data reasonably well but also highlight opportunities to enhance its overall fit.

4.6 Hypothesis Testing

Hypothesis testing was conducted to evaluate the relationships between the independent variables (Audit Quality, Auditor Reputation, and Auditor Rotation) and the dependent variable (Market Value of Companies). The results of the analysis, including the Original Sample (O), Sample Mean (M), Standard Deviation (STDEV), T-Statistics, and P-Values, are presented and discussed below.

Table 5. Hypothesis Test

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (|O/STDEV|)	P Values
Audit Quality -> Market Value of Companies	0.370	0.373	0.106	3.492	0.001
Auditor Reputation -> Market Value of Companies	0.233	0.244	0.101	2.303	0.004
Auditor Rotation -> Market Value of Companies	0.293	0.283	0.084	3.505	0.000

The interpretation of results confirms the significance of the relationships between audit quality, auditor reputation, auditor rotation, and the market value of companies.

For H1 (Audit Quality → Market Value of Companies), the path coefficient of 0.370 indicates a moderately strong positive relationship, with a T-statistic of 3.492 and a highly significant p-value of 0.001 (p < 0.05), supporting the hypothesis that high-quality audits enhance financial statement credibility, reduce information asymmetry, and boost investor confidence. For H2 (Auditor Reputation → Market Value of Companies), the path coefficient of 0.233 suggests a positive but weaker relationship, with a T-statistic of 2.303 and a significant p-value of 0.004, affirming that reputable auditors enhance trust and reliability in financial disclosures. For H3 (Auditor Rotation → Market Value of Companies), the path coefficient of 0.293 reflects a moderately strong positive relationship, with a T-statistic of 3.505 and a highly significant p-value of 0.000, indicating that auditor rotation fosters independence and objectivity, thereby increasing investor confidence, albeit slightly less strongly than audit quality. These findings align with prior research and emphasize the importance of audit practices in enhancing corporate market value.

4.6 Discussion

The hypothesis testing results provide valuable insights into the relationships between audit quality, auditor reputation, auditor rotation, and the market value of companies listed on the Indonesia Stock Exchange.

4.6.1 The Effect of Audit Quality on Market Value

The study demonstrated a significant positive relationship between audit quality and market value (Path Coefficient = 0.370, p = 0.001), highlighting the critical role of high-quality audits in enhancing the reliability and transparency of financial statements. By reducing information asymmetry between management and investors, high-quality audits instill confidence in the accuracy of reported financial performance, enabling investors to make informed decisions. This finding aligns with prior research, such as [8], [10], [27], which established that companies with high audit quality are perceived as more credible, leading to higher valuations. In the context of the Indonesia Stock Exchange, where trust in financial reporting is vital for attracting investments in a developing market, audit quality takes on heightened significance. Consequently, companies should prioritize improving audit quality by engaging competent auditors, adhering to rigorous auditing standards, and ensuring the independence of audit functions to enhance their market value and investor confidence.

4.6.2 The Effect of Auditor Reputation on Market Value

Auditor reputation was found to have a significant positive impact on market value (Path Coefficient = 0.233, p = 0.004), indicating that reputable auditors, especially those from large and well-established firms such as the "Big Four," provide more credible and unbiased audit services. The association with a reputable auditor signals reliability to investors, reducing perceived risks and enhancing market valuation. This finding aligns with the Signaling Theory, which posits that engaging a reputable auditor communicates high-quality financial reporting to the market, and is consistent with prior research, such as [13], [15], [28]–[30], which emphasized the role of auditor reputation in reducing capital costs and boosting investor confidence. Companies should therefore prioritize partnerships with reputable audit firms to strengthen market perception and attract investor interest, while policymakers should promote transparency in auditor qualifications to assist stakeholders in identifying credible auditors.

4.6.3 The Effect of Auditor Rotation on Market Value

The study found a significant positive effect of auditor rotation on market value (Path Coefficient = 0.293, p = 0.000), underscoring its role in enhancing auditor independence by preventing excessive familiarity with management, which can lead to conflicts of interest. Periodic rotation introduces a fresh perspective in auditing, helping uncover previously overlooked risks and bolstering the integrity of financial reporting. While the relationship is slightly

weaker than that of audit quality, possibly due to transitional inefficiencies like the learning curve for new auditors, mandatory auditor rotation proves beneficial in the long term by reinforcing stakeholder trust. Companies should embrace mandatory auditor rotation as an opportunity to improve audit quality and market confidence, while regulators must ensure effective implementation of these policies to maintain auditor independence without disrupting audit continuity.

4.6.4 Comparative Impact of Independent Variables

Among the three variables, audit quality exerts the strongest influence on market value, followed by auditor rotation and auditor reputation, emphasizing the pivotal role of audit quality in shaping market perceptions through its direct impact on the credibility of financial reporting. While auditor reputation and rotation contribute significantly, their effects are secondary to the overall quality of the audit process. The combined explanatory power of these variables, reflected in an R^2 value of 0.656, indicates that audit quality, auditor reputation, and auditor rotation collectively explain a substantial proportion of the variance in market value. However, the remaining 34.4% of unexplained variance suggests the influence of other factors, such as macroeconomic conditions, industry-specific variables, or additional governance mechanisms, which warrant further investigation.

4.6.5 Implications for Theory and Practice
Theoretical Contributions:

The findings align with both Agency Theory and Signaling Theory, highlighting the critical role of auditing practices in enhancing market value. Agency Theory emphasizes that auditing functions as a monitoring mechanism to align the interests of management and shareholders, thereby reducing agency conflicts and fostering trust.

Meanwhile, Signaling Theory underscores the importance of auditor reputation as a signal of reliability, which positively influences investor perceptions and contributes to improved market valuation. Together, these theoretical perspectives affirm the value of robust auditing practices in strengthening corporate governance and market confidence.

Practical Recommendations:

To maximize market value and investor confidence, companies should invest in high-quality auditing practices, engage reputable auditors, and adhere to auditor rotation policies. For regulators, it is essential to strengthen auditing standards and enforce mandatory rotation policies to ensure greater transparency and credibility within the financial reporting ecosystem, fostering trust and accountability across the market.

5. CONCLUSION

This study confirms the significant influence of audit quality, auditor reputation, and auditor rotation on the market value of companies listed on the Indonesia Stock Exchange. Audit quality emerged as the most influential factor, highlighting the critical role of accurate and transparent financial reporting in enhancing investor confidence and market valuation. Auditor reputation further contributes by signaling reliability and reducing perceived investment risks through the association with credible audit firms. While slightly less impactful, auditor rotation reinforces independence and objectivity, supporting long-term market stability. The combined explanatory power of these factors underscores the importance of robust auditing practices in shaping investor perceptions and corporate performance. These findings align with Agency Theory and Signaling Theory, demonstrating the value of corporate governance mechanisms in reducing information asymmetry and fostering trust in financial markets.

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