

AUDITORS CHARACTERISTICS AND AUDIT DELAY: EVIDENCE FROM INDONESIAN REGIONAL GOVERNMENTS

*Sutaryo Sutaryo**, *Yediel Lase***

Abstract

Overdue financial statements reporting, more specifically audit delay, can cause losses in its capacity in decision making. We investigate the effects of auditor characteristics on local governments' audit delay by studying 127 Indonesian local governments. We find that auditor professional proficiency and auditor educational background have significant effect on the audit delay of local government financial statements. Our results also indicate the intersection of some auditor characteristics in affecting audit delay. Our findings mainly suggest that the auditor professional proficiency should be improved to shrink audit delay.

Keywords: Audit Delay, Local Governments, Auditor Characteristics, Auditor Professional Proficiency, Auditor Educational Background, Auditor Tenure

**Corresponding author. Faculty of Economics and Business, Universitas Sebelas Maret. Jl. Ir. Sutami 36A, Surakarta 57126, Indonesia*

Tel: +62271647481

Fax: +62271638143

***Indonesia Supreme Audit Council*

1 Introduction

It has been widely known that timeliness of financial reporting is crucial especially with regard to its impact on decision making. Financial reports are useful if they provide information to decision maker before that information could not be able to influence the decision (Kieso, 2012). Timeliness of financial reporting depends on the audit period as financial report must be released after the audit has been done (Johnson, 1998). Auditors, therefore, are expected to work without delay, at least within the professionally and ethically limit (Carcello *et al*, 1992; DeAngelo, 1981). Audit delay refers to the distance between the end of financial period and the date of audit reporting (Payne dan Jensen, 2002; Johnson *et al*, 2002).¹⁸

Studies on the audit delay for local governments have been done in the US and Europe. Payne and Jensen (2002) document that managerial incentive is associated with timeliness of reporting and quality of financial reporting. Moreover, experience and reputation of auditors reduce the audit delay. Cohen and Leventis (2012), in the context of regional governments in Greece, find that strong opposition, size of local government, incumbent status, population, internal audit team as well as remarks are the determinants of audit delay.

The present paper investigates the determinants of audit delay especially with regard to auditor's characteristics which are measured by educational background, tenure, and professional capability. We

study in the context of public sector organizations, more specifically Indonesian local governments. Little is found on the determinants of audit delay for public sector in Indonesia as most of papers discuss the audit delay for profit organizations (Merdekawati dan Arsjah, 2011; Rahmawati, 2008). According to the Indonesian Public Accounting Standard (SAP), financial report of government must deal with four principles which are relevant, reliable, comparable and understandable. To be reliable, financial report have to provide information which have predictive ability, complete and on time.

The Indonesian government has regulated the timeliness of financial report of local government¹⁸. Financial reports have to be submitted 3 months after the end of fiscal period to the Supreme Audit Council. Then, the council has to exam those reports and releases the audit report within 2 months to the local parliament. Based on the summary of exam report for the second semester of 2012, it could be seen that 94 financial reports (18.08%) were delayed reported.

This paper could be considered as the first paper discussing the determinants of audit delay of local government in Indonesia. This paper also adds to the literature by taking into account the role of characteristics of auditor.

¹⁸ Decree of Ministry of Internal Affairs No. 13/2006 and Act No. 15/ 2004.

2 Literature review

2.1 Agency theory

Agency theory deals with the contract between principal and agent to perform on behalf of principal with some authorities to agent to make decisions (Jensen and Meckling, 1976). This theory emphasizes on the separation between principal and agent. However, this separation could lead to a conflict between principal and agent (agency problem/ agency conflict) which rises because manager may pursue private benefits (Ugurlu, 2000; Jensen dan Meckling, 1976). It is assumed that agent has more information than principal (information assymetry) which then could lead to the capability of principal to effectively monitor the agent to ensure that agent behaves for the interests of principal. The other assumption is that principal and agent behave rationally in which they will maximize their wealth. It means that agent might have private interests which is contradictory with the interest of principal. It is generally known as moral hazard problem (Adams, 1994; Mustapha dan Ahmad, 2011). The last issue is adverse selection bias in which the principal might not select the appropriate agent in terms of expertise (Gilardi, 2001). The principal has to allocate agency cost to minimize agency problem such as the monitoring cost to audit the financial report (Adams, 1994; Primadita dan Fitriany, 2012).

2.2 Agency theory in public organization

Halim and Abdullah (2006) argue that agency theory can be applied in the public organization. In such institution, the agency relationship is in the form of society to parliament, parliament to executives (government), government to minister, and government to bureaucracy (Gilardi, 2001). In Indonesia, based on the Government Rule (PP) No. 6/2005, regional head which can be governor, mayor and regent are directly elected by public in a general election. In such mechanism, public delegate their governmental authority to the regional head. It means that the regional heads serve as agent while public is the principal (Sutaryo and Winarna, 2013).

2.3 Examination of local government financial report as a monitoring mechanism

Adams (1994) explains that audit (examination) on financial reports by external auditor is an example of monitoring mechanism to ensure that agent behave in line with the interest of principal. In the context of Indonesian local governments, since 2006, it has been implemented that local government financial reports have to be audited yearly. Based on the Indonesian Law No. 15/2004, it is clearly defined that audit is the process of problem identification, analysis, and evaluation which is conducted independently,

objective, and professional based on standards to assess the truth, accuracy, credibility, and reliability of information regarding the managing and responsibility of state budget.

Audit to local government financial reports is conducted by the Supreme Audit Council (BPK), an independent state institution which is assigned to examine the management and responsibility of state budget according to the Indonesian constitution of 1945. BPK has authority to conduct three kinds of examination which are financial examination, performance examination and special purpose examination. Financial examination is aimed at providing reasonable assurance whether financial reports have been presented properly in all materials based on accounting principles applied in Indonesia or comprehensive accounting basis which are not generally applied in Indonesia. Following the examination, BPK releases opinion which is a professional statement as an auditor conclusion regarding the fairness of information presented in the financial reports.

The Law also regulates the duration of financial reporting as well as the examination of the reports. The Regulation of Ministry of Home Affairs No. 13/2006 mandates that regional heads (governor, mayor and regent) have to submit the financial reports to the BPK three months after the end of fiscal year. According to the Law No. 15/2004, it is mentioned that the BPK has to complete the examination within two months and provide the reports to regional parliament.

2.4 Audit delay

A number of studies measure audit delay as the time difference between end of fiscal year and the audit report (Payne dan Jensen, 2002; Johnson *et al.*, 2002; McLelland dan Giroux, 2000; Carslaw dan Kaplan 1991). The longer the audit delay could be considered that the timeliness of financial report becomes dwindle. The timelines of financial report is associated with the quality of information to make decision (Kieso *et al.*, 2012). In this study, we measure audit delay as the difference between the receiving of financial report until the providing the report to local parliament. It is more appropriate in the context of Indonesia as the regulations have clearly divided the period of financial reporting from local government to the BPK and the period of audit of BPK. As explained earlier,

2.5 Auditor characteristics

The process of examination/ audit is supposed to be affected by auditor characteristic. Auditor characteristic is generally identified based on the characteristic of audit institution such as public accountant office (KAP). Cohen and Leventis (2012) and Carslaw and Kaplan (1991) disentangle auditor

characteristic to international KAP and local KAP. Lowensohn *et al* (2007) categorize auditor characteristic to big five KAP and non-big five. Primadita dan Fitriany (2012) study the effect of audit tenure and specialization on asymmetry information. They divide tenure and specialization based on the level of KAP. In this paper, we identify auditor characteristics at the individual level. In an examination, the team consists of person in charge, technical control, team leader and team members. Therefore, we employ education background, repeat assignment (tenure), and professional capability to proxy auditor characteristics.

Education background could be identified based on the discipline at the university level, more specifically accounting discipline. Setyaningrum (2012) explains that accounting education is a mandatory requirement to examine financial report. Moreover, she documents that the higher the education levels the more comprehensive accounting knowledge that auditors have. In addition, she argues that education quality of examiner should be higher than executive, so that the examiner would be able to assess the conformity of executive to the applied standards. Setiawan dan Fitriany (2011) also explain that accounting expertise, proxied by accounting education background, is strongly needed for an auditor to examine financial reports to provide accurate and suitable information and to reduce the probability of fraud in the reporting process.

Auditor tenure refers to the number of repeat assignment in the same object. Almutairi *et al* (2009) explains that the longer the tenure would reduce the independency of auditor and reduce the auditor objectivity. On the other side, one might also argue that the audit quality would be improved with the longer the tenure as the auditors have more experiences and familiarity with the client especially with regard to financial reporting. Almutairi *et al* (2009) measure tenure as the consecutive years of the relations between auditor and client. Payne and Jensen (2002) argue that the longer the auditor tenure would improve the capability to facilitate the preparation of financial reports.

Auditor professional proficiency could be measured based on the professional certification in accounting. The standard of SPKN requires that auditors should collectively have appropriate professional capability. Moreover, it is also mentioned in the standard that auditors should collectively have expertise certification. Hutchison dan Fleischman (2003) point out that accounting expertise certification indicates the extent to which accountants are competent in accounting and compliance with the professional standards. Hutchison dan Fleischman (2003) explains various expertise certifications for accountant and auditors such as *Certified Public Accountant* (CPA), *Certified Fraud Examiner* (CFE), *Certified Government Auditing Professional* (CGAP),

Certified Information Systems Auditor (CISA), *Certified Internal Auditor* (CIA) and others.

2.6 Hypotheses

LKPD (Local government financial report) is prepared based on the accounting principles regulated in the Indonesian Government Accounting Standard. To examine this report, it is regulated that auditors must have capability in auditing and accounting as well as having good understanding on accounting principle for local government. In general, BPK's auditors have education background in accounting. However, complexity in examination process requires them to equip them with some other competencies such as information technology, law and engineering. In addition, BPK also recruits auditors with non-accounting education. However, they are massively educated and trained with accounting and auditing before assigned to audit. As the financial reports are highly associated with accounting discipline, it is expected that those having accounting background should complete the audit on time. Therefore, we hypothesize as follows:

H1: Education background in accounting is negatively associated with audit delay

Auditors with repeat assignments in the same local governments are expected to have more experiences and familiarity with the client so that it will ease them to complete the audit on time and appropriate. However, on the contrary, Li (2007) finds that auditor tenure is negatively associated with audit conservatism due to the over trust behavior. Such attitude could lead to negative behaviors for instance reducing audit samples and neglecting audit procedures. As there is a conflicting argument, therefore, we hypothesize as follows:

H2: Auditor repeat assignments affect the audit delay

With regard to the audit expertise, it is widely known that professional certification is offered for example *public accountant*, *Certified Public Accountant* (CPA), *Certified Information System Auditor* (CISA), *Certified Fraud Examiners* (CFE) dan others. Those certifications are recognition to the professionalism of an accountant in that field. Those having such expertise are expected to have more competences.

Better capability is considered to positively correlate with timelines of audit. Schelker (2010) empirically reveals that states in the US which require auditors to have at least CPA have less spending and liabilities and have higher bond rating compare to those do not regulate such requirement. Therefore, we hypothesize as follows:

H3: Auditor professional proficiency is negatively associated with audit delay

3 Methodology

3.1 Data

This study is a cross-sectional research. Our data consist of 127 local governments (district/ municipal

level) which have reported their 2012 audited financial statements and data on auditor characteristics are available. Detailed information on data sources are provided in Table 1.

Table 1. Data sources

Data	Sources
Examination Report	Supreme Audit Council
Examination Summary	Supreme Audit Council
Summary Report of <i>Bezzeting</i>	Supreme Audit Council
Progress Report of Examination	Supreme Audit Council
Tenure of Regent/ Mayor	Directorate of Regional Autonomy of Ministry of Home Affairs

Source: www.otda.kemendagri.go.id

3.2 Empirical model and variables

Our empirical model to be estimated is as follows:

$$\text{AUDTIME}_i = \beta_0 + \beta_1 \text{EDU}_i + \beta_2 \text{TENR}_i + \beta_3 \text{PROF}_i + \beta_4 \text{REMARKS}_i + \beta_5 \text{AUDOP}_i + \beta_6 \text{SCHE}_i + \beta_7 \text{TYPE}_i + \beta_8 \text{ACCETY}_i + \beta_9 \text{REELC}_i + \varepsilon$$

AUDTIME is audit delay which is measured as the natural logarithm of total dates (the distance between received dates of financial report until the reported date). EDU is the educational background of auditor which is measured as the percentage of number of auditors possesses accounting degree over the total auditors within the team. TENR is repeated assignment which is defined as the percentage of number of auditors examining the similar entity in two consecutive years. PROF is the proxy of auditor's capability which is measured as the percentage of auditors having professional certificate to total auditors within the team. REMAKS is the sum of number of exceptional items and number of restricted items in the audit report. AUDOP is the opinion of audit which is a dummy variable taking a value of 1 for unqualified (without opinion) and 0 otherwise. SCHE is the audit schedule which is measured as a dummy variable taking a value of 1 for financial reports which are audited in the first semester and 0

for second semester. TYPE is types of local government which is measured as a dummy variable taking a value of 1 for municipal and 0 otherwise. ACCETY is number of accounting entity within a local government. REELC is a dummy variable to measure the incumbency of head of region, taking a value of 1 for regions with incumbent and 0 otherwise.

4 Results and discussion

4.1 Descriptive statistics and correlation

We investigate the determinants of audit delay especially with regard to auditor's characteristics which are measured by educational background, tenure, and professional capability.

Table 2 and 3 exhibit the descriptive statistics and correlation matrix of variables. The average audit delay (AUDTIME) is 4.26 or 70.8 days which is longer than the regulation (60 days). The average accounting education (EDU) is 0.7 which means 70% of auditors have accounting education background. In average, 46% of auditors are professionally certified (PROF). The average tenure (TENR) is 14% which shows that there is relatively regular rotation. As shown in Table 3, PROF, SCHE and TYPE are significantly correlated with AUDTIME.

Table 2. Descriptive statistics of variables

	N	Min	Max	Mean	Std. Deviation
AUDTIME	127	3.81	5.03	4.26	0.28
EDU	127	0.33	1.00	0.70	0.14
TENR	127	0.00	0.50	0.14	0.13
PROF	127	0.13	0.83	0.46	0.15
REMARKS	127	0	12	3.76	2.89
AUDOP	127	0	1	0.65	0.48
SCHE	127	0	1	0.69	0.46
TIPE	127	0	1	0.15	0.35
ACCETY	127	15	96	41.61	16.22
REELC	127	0	1	0.17	0.37

Table 3. Correlation matrix of variables

		AUDTIME	TENR	PROF	EDU	REMARKS	AUDOP	SCHED	ACCETY	TIPE	REELC
AUDTIME	Pearson Correlation	1									
	Sig. (2-tailed)										
TENR	Pearson Correlation	-.095	1								
	Sig. (2-tailed)	.345									
PROF	Pearson Correlation	-.326^a	.096	1							
	Sig. (2-tailed)	.001	.341								
EDU	Pearson Correlation	.143	.050	.311^a	1						
	Sig. (2-tailed)	.152	.617	.002							
REMARKS	Pearson Correlation	.008	.462^a	-.090	-.047	1					
	Sig. (2-tailed)	.938	.000	.372	.639						
AUDOP	Pearson Correlation	.030	-.410^a	.018	-.028	-.581^a	1				
	Sig. (2-tailed)	.768	.000	.855	.779	.000					
SCHED	Pearson Correlation	-.380^a	-.329^a	.061	.027	-.466^a	.722^a	1			
	Sig. (2-tailed)	.000	.001	.547	.787	.000	.000				
ACCETY	Pearson Correlation	.100	-.383^a	.069	-.012	-.490^a	.510^a	.433^a	1		
	Sig. (2-tailed)	.319	.000	.493	.908	.000	.000	.000			
TIPE	Pearson Correlation	.276^a	-.064	.013	.150	-.103	.179	.104	-.057	1	
	Sig. (2-tailed)	.005	.527	.900	.133	.306	.073	.301	.572		
REELC	Pearson Correlation	.019	.008	-.112	-.235^b	-.124	-.035	.119	.075	-.123	1
	Sig. (2-tailed)	.853	.935	.267	.018	.216	.729	.237	.453	.222	

Note: b and a indicate significance at the 5%, and 1% levels, respectively

4.2 Empirical results

We exclude 26 outliers from our sample which indicated by case wise list technique. We estimate our model on the determinants of audit delay by employing an ordinary least square. Table 4 presents

the regression results without interaction variables. Professional certification (PROF) is negatively associated with audit delay. Those who are not certified have longer average audit delay than that of professionally certified auditors.

Table 4. Regression results

	1	2	3	4
CONSTANT	4.122	4.291	3.857	4.014
TENR	54.340	51.374	34.999	40.225
	-0.196			-0.134
	-1.403			-1.112
PROF		-0.425		-0.533
		-4.068^a		-5.331^a
EDU			0.303	0.467
			2.684^a	4.572^a
REMARKS	0.009	0.004	0.009	0.008
	1.242	0.565	1.227	1.288
AUDOP	0.245	0.228	0.277	0.257
	4.269^a	4.262^a	4.916^a	5.220^a
SCHED	-0.423	-0.404	-0.437	-0.427
	-8.194^a	-8.384^a	-8.643^a	-9.682^a
ACCETY	0.003	0.004	0.003	0.003
	2.571^b	3.208^a	2.862^a	3.315^a
TIPE	0.185	0.186	0.170	0.161
	4.088^a	4.420^a	3.811^a	4.161^a
REELC	0.104	0.075	0.131	0.120
	2.336^b	1.795^c	2.932^a	3.052^a
R2	0.486	0.555	0.513	0.640
ADJ R2	0.447	0.521	0.476	0.605
Observation	101	101	101	101

Note: The values in parentheses are t value. b and a indicate significance at the 5%, and 1% levels, respectively

The average accounting education (EDU) is positively and significantly associated with audit delay. It could be concluded that the higher the proportion of team members having accounting education, the longer the audit time. It may be explained by the facts that audit does not necessarily depend on the accounting expertise but it should also be complemented by other expertise (law, information technology, engineering...). We do not find evidence on the impact of tenure (TENR) on audit time. All control variables (AUDOP, SCHED, ACCETY, TIPE, dan REELC) are significantly associated with audit time.

Table 5 exhibits the regression results of interactions between our main variables (educational background, tenure, and professional capability). We do find a significant and negative coefficient for the interaction between professional capability (PROF) and tenure (TENR). The negative effect of professional capability on audit delay will be strengthened if the auditors are tasked in a repeated assignment. Likewise, the interaction between professional capability (PROF) which is measured as

the percentage of auditors having professional certificate to total auditors within the team and education background (EDU) is negative and significant. It means that the professional capability supported by accounting education could be more beneficial to minimize the audit delay.

5 Conclusion

Our study is aimed at investigating the determinants of audit delay. We emphasize on the auditor's characteristics which are educational background, tenure, and professional capability. We study audit of local government financial report in the context of Indonesia. We do find that auditor capability is the most important factor to ensure the timeliness of audit. Consequently, the capability of professional auditor is separately regulated in the Standards for State Financial Examination (SPKN) of the Supreme Audit Council (BPK). However, our study fails to find evidence on the impact of repeated assignment (tenure) has an impact on audit delay.

Table 5. Regression results with interaction variables

	1	2	3	4	5	6
CONSTANT	4.318	4.141	3.940	4.102	4.021	4.158
	42.271	56.322	28.233	53.715	14.381	50.542
TENR	-0.207		-0.649			
	-0.507		-0.974			
PROF	-0.443				-0.592	
	-2.653^a				-1.024	
EDU			0.243		0.437	
			1.478		1.214	
TENRxPROF	0.210	-0.600				
	0.256	-2.468^b				
TENRxEDU			0.584	-0.120		
			0.640	-0.646		
PROFxEU					0.056	-0.200
					0.073	-1.731^c
REMARKS	0.005	0.010	0.012	0.008	0.006	0.005
	0.757	1.396	1.660	1.021	1.002	0.701
AUDOP	0.222	0.243	0.272	0.247	0.260	0.238
	4.054^a	4.350^a	4.846^a	4.254^a	5.196^a	4.143^a
SCHED	-0.403	-0.428	-0.443	-0.421	-0.424	-0.413
	-8.095^a	-8.461^a	-8.787^a	-8.083^a	-9.358^a	-8.006^a
ACCETY	0.003	0.003	0.003	0.003	0.004	0.004
	3.025^a	2.516^b	2.576^b	2.678^a	3.430^a	2.939^a
TIPE	0.185	0.188	0.170	0.186	0.161	0.192
	4.341^a	4.233^a	3.836^a	4.072^a	4.087^a	4.257^a
REELC	0.077	0.104	0.140	0.100	0.115	0.083
	1.805^c	2.386^b	3.123^a	2.227^b	2.910^a	1.841^c
R2	0.558	0.508	0.530	0.478	0.635	0.492
ADJ R2	0.514	0.470	0.484	0.438	0.599	0.453
Observation	101	101	101	101	101	101

Note: The values in parentheses are t value. b and a indicate significance at the 5%, and 1% levels, respectively

Some limitations of this present paper are admitted. First, this paper relies on a cross-sectional data of 127 local governments which could not capture the differences in period. Second, we do not take into account some control variables such as auditor tenure and advance education of auditor.

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