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The Effect of Prudence, Financial Distress and Litigation Risk on Audit Quality Moderated by the Characteristics of the Audit Committee Chairman

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Abstract: This study aims to examine the influence of Prudence, Financial Distress, and Audit Quality on Audit Quality and to explain the role of the audit committee chairman as a moderator of the influence of Prudence, Financial Distress, and Audit Quality on Audit Quality. The type of data used in this study is primary data in the form of financial reports of companies used as samples. The research method used in this study is a quantitative research method. The sample was selected using a purposive sampling method. For hypothesis testing, this study uses multiple linear regression analysis. Based on the expected research results in this study are Prudence influences audit quality, Financial Distress with the Springate method influences audit quality, Financial Distress with the Zmijewski method influences audit quality, Litigation Risk influences audit quality, The characteristics of the Audit Committee Chairman strengthen the influence of Prudence on audit quality, The characteristics of the Audit Committee Chairman strengthen the influence of Financial Distress with the Springate method on audit quality. The characteristics of the Audit Committee Chairman strengthen the influence of Financial Distress with the Zmijewski method on audit quality. The characteristics of the Audit Committee Chairman strengthen the influence of Litigation Risk on audit quality.

Keywords: Prudence, Financial Distress, Litigation Risk, Audit Quality, Characteristics of the Audit Committee Chair

INTRODUCTION

The public accounting profession is a profession based on complex knowledge and can only be performed by individuals with specific skills and educational backgrounds. One of the duties of public accountants in carrying out their profession is to provide useful information to the public for economic decision-making. Auditors are given significant trust by stakeholders in financial reports, which ultimately leads to auditors maintaining the quality of their audits. Despite significant questions from external stakeholders about the quality of auditors' audits, due to numerous scandals involving auditors, to achieve good audit quality, auditors must adhere to the professional standard accountant's code of ethics and applicable financial accounting standards in Indonesia.

The first factor influencing audit quality is prudence, which is an accounting practice that exceeds conservatism and ensures that a company is not overstated. This practice prevents overstatement of profits/revenues and assets in a company's reporting (ACCA, 2020). The application of this prudential principle allows for the recognition of probable expenses and losses as soon as possible if they are foreseeable, while delaying the recognition of future revenues or gains. Therefore, it can be concluded that the resulting financial reports tend to understate profits and asset values, as a precautionary measure.

Financial distress can create additional constraints on the audit process and affect the independence, objectivity, and overall audit quality. Companies experiencing financial distress face higher materiality risks and greater time and resource pressures during the audit process. Financial distress can create complex conflicts of interest for auditors, especially if the auditor has a long-term relationship with the company. Auditors must ensure that their independence is not affected by external pressures that may arise in financial distress. Financial distress, often known as financial distress, is something all companies strive to avoid. Financial distress is defined as a company's financial condition where there is a cash shortage on the asset side and an excess of debt on the liability side (Saji, 2018).

Litigation risk is an inherent risk in a company that poses a potential threat of litigation from parties who feel aggrieved by the company. These stakeholders include creditors and investors. Litigation risk can be measured using various financial indicators that determine the likelihood of litigation (Subhan and Damayanti, 2019). Dr. F. H. Winarta stated that the litigation process pits the parties against each other, and that litigation dispute resolution is a final resort (ultimum remidium) after other dispute resolution alternatives have failed.

Based on the above phenomenon, researchers are interested in examining the influence of prudence, financial distress, and litigation risk on audit quality. Researchers added the audit committee chairman as a moderator because the audit committee plays a crucial role in carrying out its duties, including in external audit mechanisms. Therefore, the effectiveness of the audit committee depends on the leadership of the committee chairman in setting the tone, style, and work agenda of the committee (KPMG, 2019). The characteristics of the audit committee chairman will significantly influence audit quality (Broye & Johannes, 2023).

METHOD

Research Procedure

According to Sugiyono (2018, p. 35), research subjects play a crucial role in any research activity. Therefore, identifying and determining the research subjects must be carried out carefully and thoroughly before the data collection process begins. Research subjects are the parties or entities that become the focus of data gathering and analysis. In this study, the research subjects are companies operating in the energy sector. The selection of these subjects is based on their relevance to the research topic, especially in relation to the dynamics and characteristics of the energy sector, which is considered strategic and dynamic in the context of economic development and environmental sustainability.

Research Object

This study adopts a quantitative research design, specifically employing an associative analysis approach that aims to explore the relationship between two or more variables. As described by Sugiyono (2018, p. 23), quantitative methods are based on the philosophy of positivism, where research is conducted on specific and limited populations or samples. Data collection is performed using structured research instruments, and the data is analyzed using quantitative or statistical techniques. The main objective of this approach is to provide an objective depiction of the phenomena under study, as well as to test predefined hypotheses. Through this method, the research aims to produce conclusions that are empirically measurable, statistically reliable, and limitedly generalizable.

Research Sample

The selection of samples in this study refers to the definition provided by Sugiyono (2018, p. 139), who states that a sample is a subset of the total population that possesses certain characteristics representative of that population. Sampling is conducted to increase efficiency without compromising the validity and reliability of the research outcomes. This study utilizes a non-probability sampling technique, which means not every element or member of the population has an equal chance of being selected. Specifically, this research adopts purposive sampling, a technique in which the sample is chosen based on specific criteria or considerations established by the researcher. These criteria ensure that the selected sample is highly relevant and appropriate for addressing the research objectives. In this context, the sample consists of energy sector companies that meet certain conditions, such as data completeness, transparency in financial reporting, and consistency in providing relevant information during the observation period.

Hypothesis

a) H1: Prudence is associated with audit quality
b) H2: Financial statements of companies with poor financial health or potential bankruptcy are associated with audit quality using the Springate model
c) H3: Financial statements of companies with poor financial health or potential bankruptcy are associated with audit quality using the Zmijewski model
d) H4: Litigation risk is associated with audit quality
e) H5: Audit committee chair characteristics strengthen the influence of prudence on audit quality
f) H6: Audit committee chair characteristics strengthen the influence of financial statements of companies with poor financial health or potential bankruptcy on audit quality using the Grover model
g) H7: Audit committee chair characteristics strengthen the influence of financial statements of companies with poor financial health or potential bankruptcy on audit quality using the Zmijewski model
h) H8: Audit committee chair characteristics strengthen the influence of litigation risk on audit quality

RESULTS AND DISCUSSION

The following are descriptive statistics for each of the variables studied.

Table 1. Descriptive Statistics

Descriptive Statistics					
	N	Minimum	Maximum	Mean	Std. Deviation
PRUD	133	0.276	0.525	0.343	0.37088
FIN_DISS	133	2.22	8.20	5.4123	1.76516
FIN_DISX	133	0.23	3.21	0.7432	0.48875
RISK_LIT	133	0.41	2.12	1.0058	1.23211
KKA	133	1	4	2.312	0.21233
KA	133	0.000021	0.4300	0.00232	0.22131
Valid N (listwise)	133				

Source: Data processed SPSS by Researchers (2025)

Classical Assumption Test

a) Normality Test

The following are the results of the normality test.

Table 2. Normality Test

One-Sample Kolmogorov-Smirnov Test		
		Unstandardized Residual
N		133
Normal Parameters[a,b]	Mean	.0000000
	Std. Deviation	.84524092
Most Extreme Differences	Absolute	.256
	Positive	.154
	Negative	-.256
Test Statistic		.256
Asymp. Sig. (2-tailed)		.867[a]
a. Test distribution is Normal.		
b. Calculated from data.		

Source: Data processed SPSS by Researchers (2025)

Based on the research results, we can see that the significance value (Asymp. Sig. (2-tailed)) is 0.867, or greater than 0.05, which means the data used for this study is normally distributed.

Heteroscedasticity test

The following are the results of the heteroscedasticity test:

Table 3. Heteroscedasticity Test

Coefficients[a]						
		Unstandardized Coefficients		Standardized Coefficients		
Model		B	Std. Error	Beta	t	Sig.
1	(Constant)	.404	.630		.483	.630
	PRUD	-.293	.059	-.746	-3.280	.761
	FIN_DISS	.568	.225	1.599	2.077	.383
	FIN_DISX	.671	.082	.812	3.312	.319
	RISK_LIT	-.289	.203	-1.694	-2.899	.533
	KKA	.324	.445	.432	3.3421	.354
a. Dependent Variable: Abs_RES						

Source: Data processed by Researchers (2023)

The table above shows that the t-test significance value for all independent variables, with an Absolute Residual (ABS_RES) greater than 0.05, indicates that there is no heteroscedasticity problem in this research's regression model.

Multicollinearity Test

The following are the results of the multicollinearity test.

Table 4. Multicollinearity Test

Coefficients[a]								
		Unstandardized Coefficients		Standardized Coefficients	T	Sig.	Collinearity Statistics	
Model		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	5.291	1.063		4.980	.000		
	PRUD	.583	.320	.602	5.451	.000	.709	5.391
	FIN_DISS	.868	.380	1.838	4.918	.000	.793	5.521
	FIN_DISX	.540	.138	-.466	-3.913	.000	.719	5.906
	RISK_LIT	.374	.343	-1.138	-4.010	.000	.761	5.019
	KKA	.456	.323	-2.421	-3.321	.000	.654	5.245

Source: Data processed by Researchers (2023)

In the table above, we can see that no independent variables have a Tolerance value of less than 0.1, and no independent variables have a Variance Inflation Factor (VIF) value of more than 10. Therefore, we can conclude that there is no multicollinearity among the independent variables in the regression model.

Autocorrelation Test

The following are the results of the Autocorrelation test:

Table 5. Autocorrelation Test

Model Summary[b]

Model	R	R Square	Adjusted Square	RStd. Error of the Estimate	Durbin-Watson
1	.894[a]	.800	.795	.957	1.803

a. Predictors: (Constant), PRUD, KKA, FIN_DISS, FIN_DISX, RISK_LIT

b. Dependent Variable: KA

Source: Data processed by Researchers (2023)

The Durbin Watson (d) value in the processed data from this study was 2.103, meaning du < d < 4-du, i.e., 1.6932 < 1.803 < 2.3068. This result indicates that there is no autocorrelation in this research model.

Hypothesis Test

Essentially, a statistical test shows the extent to which an individual independent variable can explain the variation in the dependent variable (Ghozali, 2011). The basis for making decisions in this partial test is comparing the p-value with an α of 0.05. 1. If the significance value is < 0.05, then H1 is accepted. 2. If the significance value is > 0.05, then H0 is accepted.

The following are the regression results:

Table 6. Regression Test

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	13.344	9.807		2.425	.016
	PRUD	.227	.099	.587	5.323	.000
	FIN_DISS	.454	1.279	.151	.120	.805
	FIN_DISX	.365	1.169	.487	2.483	.030
	RISK_LIT	1.127	.523	1.761	3.063	.000
	KKA	1.020	.001	.867	2.825	.000
	PRUD* KKA	1.066	.051	2.833	1.308	.003
	FIN_DISS*KKA	1.040	.050	1.397	.801	.205
	FIN_DISX*KKA	2.321	.321	1.231	4.323	.003
	RISK_LIT*KKA	3.321	.231	2.121	3.421	.023

a. Dependent Variable: KA

Source: Data processed by Researchers (2025)

CONCLUSION

This study shows that prudence is significantly associated with audit quality, and the financial statements of companies with poor financial health or potential bankruptcy are significantly associated with audit quality. These results align with stakeholder theory, which states that companies have a responsibility to meet the needs and expectations of stakeholders, including investors, creditors, and regulators. Therefore, high audit quality is crucial for

enhancing stakeholder trust and mitigating risks associated with investment and credit decisions.

Therefore, auditors must consider prudence and the company's financial health when conducting audits to improve audit quality and meet stakeholder needs. This study also shows that litigation risk is significantly and positively associated with audit quality. This means that the higher the litigation risk, the higher the audit quality. The results of this study indicate that auditors facing high litigation risk tend to be more careful and thorough in their audits, thereby improving audit quality. Therefore, this study contributes to the understanding of the factors influencing audit quality and can be used as a reference for auditors and regulators to improve audit quality.

This study also shows that the Chairman of the Audit Committee as a moderator strengthens the influence of Prudence and Financial Distress on audit quality. This means that the presence of an effective Chairman of the Audit Committee can strengthen the relationship between Prudence and audit quality, as well as the relationship between Financial Distress and audit quality. Thus, this study shows that the role of the Chairman of the Audit Committee is very important in improving audit quality by strengthening the influence of factors that affect audit quality, such as Prudence and Financial Distress. The results of this study can be used as a reference for companies and regulators to improve audit quality by considering the role of the Chairman of the Audit Committee.

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