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Audit Quality and Idiosyncratic Stock Price Volatility: Evidence from Auditor Tenure and Big Four Auditors in Indonesian Non-Financial Firms

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ABSTRACT

This study examines the relationship between auditor tenure, audit firm size, and idiosyncratic stock price volatility. Idiosyncratic volatility reflects firm-specific risk arising from uncertainty related to a company's future performance. Using a sample of non-financial firms listed on the Indonesia Stock Exchange during the period 2013–2017, this study employs annual financial statements, audit reports, and weekly stock price data. Idiosyncratic stock price volatility is measured using the Stock Price Idiosyncratic Volatility (SPIV) approach derived from the market model. Multiple linier regression is applied to test the hypotheses. The results show that auditor tenure has a significant negative effect on idiosyncratic stock price volatility, indicating that longer auditor–client relationships improve auditors' understanding of client operations and enhance financial reporting credibility. Furthermore, firms audited by Big Four audit firms exhibit lower idiosyncratic stock price volatility, suggesting that higher audit quality reduces information asymmetry and firm-specific risk perceived by investors. Several control variables, including trading volume, firm size, market-to-book ratio, and business segments, are also found to significantly influence idiosyncratic volatility. These findings highlight the role of audit quality as an important governance mechanism that improves information transparency and contributes to more stable stock prices in the Indonesian capital market.

Keywords: auditor tenure, audit firm size, idiosyncratic stock price volatility

INTRODUCTION

Idiosyncratic volatility represents firm-specific risk that arises from uncertainty related to the future performance of individual companies. Unlike systematic risk, which is driven by market-wide movements, idiosyncratic volatility reflects fluctuations in stock prices that originate from firm-level characteristics and information unique to a particular company (Naomi, 2011). In capital market research, idiosyncratic volatility is frequently interpreted as an indicator of the extent to which firm-specific information is incorporated into stock prices. Previous studies show that stock price movements with higher idiosyncratic components often reflect a stronger influence of company-specific information and investor responses to such information (Fernandes & Ferreira (2009) and Ferreira & Laux (2005). However, excessive idiosyncratic volatility may also signal uncertainty about a firm's financial condition and reporting quality. Rajgopal & Venkatachalam (2011) find that firms with lower financial reporting quality tend to exhibit higher idiosyncratic stock price volatility, indicating that the credibility of financial information plays an important role in shaping firm-specific risk perceived by investors.

From the perspective of capital market information efficiency, the quality of financial reporting determines how accurately firm-specific information is reflected in stock prices. High-quality financial reporting reduces uncertainty about firm performance and improves investors' ability to evaluate the economic fundamentals of a company. Conversely, poor financial reporting quality

may increase uncertainty and lead investors to rely on speculation or private information, resulting in greater fluctuations in stock prices. Empirical research supports this relationship, showing that firms with weak earnings quality tend to experience higher idiosyncratic volatility due to greater uncertainty surrounding financial disclosures Rajgopal & Venkatachalam (2011). Therefore, improving the reliability and transparency of financial reporting becomes an important mechanism for reducing firm-specific risk and enhancing the informational efficiency of stock prices.

Agency theory explains why financial reporting quality can influence idiosyncratic stock price volatility. The separation between ownership and control creates information asymmetry between managers and shareholders, as managers possess more detailed knowledge about firm operations and financial conditions than external investors (Jensen & Meckling, 1976). In such circumstances, managers may have incentives to manipulate or delay the disclosure of unfavorable information, thereby increasing uncertainty in capital markets. One governance mechanism designed to mitigate this problem is external auditing. Independent auditors act as monitoring agents who verify the fairness of financial statements and enhance the credibility of corporate disclosures. Empirical studies indicate that high audit quality can constrain managerial opportunistic behavior such as earnings manipulation and the withholding of bad news, thereby improving the reliability of financial reporting and reducing investors' uncertainty Balsam et al. (2003) ; d by greater audit quality, according to empirical research. According to Khajavi & Zare (2016). Evidence from Indonesia also highlights that auditor characteristics, including professional skepticism and ethical behavior, significantly influence audit quality and the credibility of financial reporting (Sari & Januarti, 2024).

Two commonly used proxies of audit quality are auditor tenure and audit firm size. Auditor tenure reflects the length of the auditor–client relationship and may influence the effectiveness of the auditing process. Longer auditor tenure may improve audit quality because auditors develop a deeper understanding of client operations, accounting systems, and reporting risks over time Su et al. (2016). However, excessively long auditor tenure may also threaten auditor independence due to economic dependence or familiarity with management (Ghosh & Moon, 2005; Kyriakou & Dimitras, 2018). Similarly, audit firm size is frequently associated with audit quality. Big Four audit firms are often considered to provide higher-quality audits because of their greater resources, stronger quality control systems, and global reputation Gul et al. (2010). Nevertheless, empirical evidence remains inconclusive. Some studies find that Big Four auditors significantly improve financial reporting quality and reduce firm-specific risk, while others argue that non-Big Four auditors may also deliver comparable audit quality, particularly in emerging markets such as ASEAN countries (Khurana & Raman, 2004).

Despite the growing literature on audit quality and capital market outcomes, empirical evidence regarding the relationship between auditor characteristics and idiosyncratic stock price volatility remains limited, particularly in emerging markets such as Indonesia. Previous studies provide mixed findings concerning the role of auditor tenure and Big Four audit firms in reducing firm-specific stock price volatility. This study therefore aims to examine whether auditor tenure and audit firm size influence idiosyncratic stock price volatility among non-financial firms listed on the Indonesia Stock Exchange during the period 2013–2017. By focusing on the Indonesian capital market, this research contributes to the literature on audit quality and capital market efficiency by providing evidence from an emerging market context. Based on the theoretical arguments and empirical evidence discussed above, this study proposes that longer auditor tenure and the use of Big Four auditors are associated with lower idiosyncratic stock price volatility.

LITERATURE STUDY

Theoretical Background

Agency Theory

According to agency theory, the separation of ownership and control creates information asymmetry between managers (agents) and shareholders (principals), because managers possess more detailed information regarding the firm's operations and financial condition than external investors (Jensen & Meckling, 1976). This asymmetry increases uncertainty for investors when assessing a firm's fundamental value and may be reflected in higher idiosyncratic stock price

volatility. External auditing functions as a governance mechanism designed to mitigate this problem by providing independent verification of financial statements and enhancing the credibility of corporate disclosures.

Auditor characteristics influence how effectively this monitoring function operates. Auditor tenure, which refers to the length of the auditor–client relationship, can improve monitoring effectiveness through a learning effect. Over time, auditors accumulate deeper knowledge about the client's business environment, internal control systems, and reporting risks. This accumulated knowledge enables auditors to identify irregularities and potential misstatements more efficiently, thereby strengthening the monitoring role of external audits and improving the reliability of financial reporting. As financial reporting becomes more credible, information asymmetry between managers and investors decreases, reducing uncertainty regarding firm-specific information and ultimately lowering idiosyncratic stock price volatility.

In addition to auditor tenure, audit firm size is frequently used as a signal of audit quality in capital markets. Large audit firms, particularly the Big Four, possess greater professional resources, stronger internal quality control systems, and higher reputational capital compared with smaller audit firms. Because reputational damage from audit failure would impose significant economic costs on large audit firms, they have stronger incentives to maintain high audit standards and provide more reliable assurance services. Consequently, the appointment of a Big Four auditor signals higher financial reporting credibility to investors. This signal of quality can reduce perceived information risk and improve investor confidence in publicly disclosed financial information, which may ultimately reduce firm-specific uncertainty reflected in idiosyncratic stock price volatility.

Hypotheses and Analytical Model

As capital markets increasingly rely on timely and credible information, the extent and reliability of corporate disclosure play an essential role in improving market efficiency. Greater transparency reduces information asymmetry between managers and investors and enhances the credibility of corporate reporting, which ultimately lowers the cost of capital and improves market liquidity (Healy & Palepu, 2001). In this context, firm-specific information contained in financial reports contributes significantly to the variation in stock returns (Roll, 1988). When financial reporting quality improves, investors can evaluate firm fundamentals more accurately, which reduces uncertainty and stabilizes stock price movements (Rajgopal & Venkatachalam, 2011). Consequently, more reliable information disclosure contributes to more efficient capital allocation and lower idiosyncratic stock price volatility (Durnev et al., 2003).

Auditor tenure represents one of the key auditor characteristics that may influence audit quality and the credibility of financial reporting. Theoretically, auditor tenure presents both benefits and potential risks. On the one hand, a longer auditor–client relationship allows auditors to accumulate client-specific knowledge regarding the firm's operations, accounting systems, and internal control structures. This learning effect enables auditors to detect irregularities and reporting risks more effectively, thereby strengthening the monitoring role of external auditing and improving financial reporting quality (Ghosh & Moon, 2005). On the other hand, excessively long auditor tenure may threaten auditor independence due to familiarity with management or economic dependence on the client, potentially weakening professional skepticism (Bamber & Iyer, 2007).

Despite these competing perspectives, several empirical studies suggest that the learning effect tends to dominate the potential independence risk, particularly when regulatory oversight and professional standards remain strong. Longer auditor tenure has been associated with improved audit effectiveness and greater investor confidence in financial reporting, which reduces information uncertainty in capital markets (Jorjani & Gerayeli, 2018; Su et al., 2016). As investors perceive audited financial statements as more reliable, their incentives to acquire private firm-specific information decrease, leading to lower firm-specific volatility in stock prices. Based on this argument, this study expects that the monitoring benefits derived from the learning effect of auditor tenure outweigh the potential independence concerns. Therefore, the following hypothesis is proposed:

H1: An increase in auditor tenure has a negative effect on idiosyncratic stock price volatility.

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External auditors act as intermediaries between management and shareholders by enhancing the credibility of financial information communicated to the capital market. In this role, audit quality becomes an important mechanism for reducing information asymmetry and improving the reliability of firm-specific disclosures. Large international audit firms, particularly the Big Four, are widely perceived to provide higher audit quality due to their stronger professional expertise, more sophisticated audit methodologies, and stricter internal quality control systems. Empirical studies suggest that Big Four auditors are more effective in reducing financial reporting errors and mitigating financial market risk, thereby improving the credibility of corporate disclosures Robin & Zhang (2015) and the other by Hakim & Omri (2010).

However, the relationship between audit firm size and audit quality is not always straightforward. Some studies argue that non-Big Four audit firms can also deliver reliable audits, particularly when they possess sufficient industry expertise and maintain strong professional standards (Francis & Yu, 2009). Evidence from emerging markets further indicates that Big Four auditors do not always produce more conservative financial reporting compared with non-Big Four auditors, especially in certain institutional environments such as ASEAN countries (Khurana & Raman (2004). These findings suggest that audit firm size alone may not fully determine audit quality.

Despite these mixed findings, the reputational capital and global credibility associated with Big Four audit firms often function as a quality signal in capital markets. Investors tend to perceive financial statements audited by Big Four firms as more reliable because these firms face greater reputational risk and therefore have stronger incentives to maintain high audit standards. As a result, the appointment of a Big Four auditor can increase investor confidence in financial reporting and reduce perceived information risk. Improved credibility of firm-specific information decreases uncertainty among investors and reduces fluctuations in stock prices that originate from firm-level information. Consistent with this reasoning, previous empirical evidence shows that firms audited by Big Four auditors tend to exhibit lower idiosyncratic stock price volatility due to improved financial reporting credibility (Gul et al., 2010). Based on this argument, the following hypothesis is proposed:

H2: Firms audited by Big Four audit firms exhibit lower idiosyncratic stock price volatility.

Control Variables

To isolate the effect of auditor tenure and audit firm size on idiosyncratic stock price volatility, several firm-level control variables are included in the regression model. These variables are commonly used in prior capital market studies because they may influence the amount of firm-specific information incorporated into stock prices.

First, trading volume (VOL) is included to capture stock liquidity. Higher trading activity reflects more intensive information processing by investors and facilitates the incorporation of firm-specific information into stock prices. Firms with higher liquidity generally experience lower volatility arising from information frictions.

Second, going concern opinion (GC) is incorporated to account for financial distress signals. A going concern audit opinion indicates potential financial uncertainty, which may increase investors' perception of firm-specific risk and contribute to higher idiosyncratic volatility.

Third, client importance (CLIENTIM) measures the economic dependence between auditors and their clients. When a client represents a significant portion of the auditor's portfolio, auditors may face incentives that influence reporting behavior, potentially affecting financial reporting credibility and investor perceptions of risk.

Fourth, firm size (SIZE) is included because larger firms generally have more stable operations, better internal control systems, and greater analyst coverage. These characteristics reduce uncertainty about firm fundamentals and may decrease idiosyncratic volatility.

Fifth, return on assets (ROA) captures firm profitability. Higher profitability reflects better operating performance and financial stability, which may reduce uncertainty surrounding firm value.

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Sixth, loss (LOSS) is included as an indicator of poor financial performance. Firms reporting losses tend to face higher uncertainty regarding future performance, which may increase firm-specific stock price volatility.

Seventh, leverage (LEV) measures the extent of a firm's financial obligations. Highly leveraged firms face greater financial risk and are more sensitive to changes in economic conditions, potentially increasing idiosyncratic volatility.

Eighth, market-to-book ratio (MB) represents a firm's growth opportunities and market expectations. Firms with high growth prospects often experience greater sensitivity to firm-specific information, which may influence stock price volatility.

Ninth, firm age (AGE) is included to control for organizational maturity. Older firms tend to have more established operations and more predictable financial performance, which may reduce uncertainty and firm-specific volatility.

Finally, business segments (SEG) capture the degree of operational diversification. Firms operating across multiple segments may exhibit more complex information environments, which can influence the level of firm-specific information incorporated into stock prices.

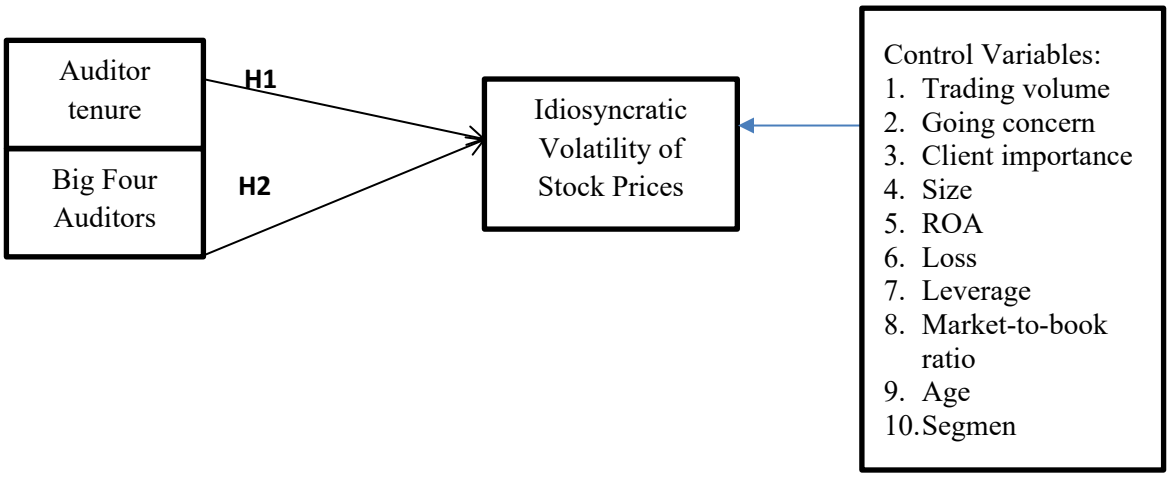

Figure 1. Conceptual Framework

METODE

Research Design and Approach

The purpose of this explanatory quantitative study is to look at how auditor traits affect idiosyncratic stock price volatility.

Research Variables

In this study, idiosyncratic stock price volatility (SPIV) serves as the dependent variable, representing the level of firm-specific risk reflected in stock price movements. The main independent variables are auditor tenure and audit firm size, which are used as proxies for audit quality. Auditor tenure captures the length of the auditor–client relationship, while audit firm size reflects whether the firm is audited by a Big Four audit firm. To reduce potential bias arising from firm-specific characteristics, several control variables are included in the regression model. These variables consist of trading volume (VOL), going concern opinion (GC), client importance (CLIENTIM), firm size (SIZE), return on assets (ROA), firm loss (LOSS), leverage (LEV), market-to-book ratio (MB), firm age (AGE), and business segments (SEG). The inclusion of these control variables allows the analysis to better isolate the effect of auditor characteristics on idiosyncratic stock price volatility.

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Variable Measurement

Variable	Operational Definition	Indicator	Measurement Scale
Idiosyncratic Stock Price Volatility (SPIV)	Firm-specific stock price volatility that reflects fluctuations in stock returns caused by company-specific information rather than market-wide movements.	Calculated from the residual variance of the market model using weekly stock returns within a fiscal year: $SPIV_{i,t} = \log\left(\frac{1 - R^2_{i,t}}{R^2_{i,t}}\right)$ $R^2_{i,t}$ = denotes the coefficient of determination of market returns on the individual stock returns of firm *i* in fiscal year *t* $1 - R^2_{i,t}$ = represents the proportion of return variation attributable to firm-specific factors, or idiosyncratic risk	Ratio
Auditor Tenure (TENURE)	The length of the auditor–client relationship, representing the number of consecutive years the same auditor audits a particular firm.	Number of years the audit firm has continuously audited the company since the initial engagement.	Ratio
Audit Firm Size (BIG4)	A proxy for audit quality based on whether the company is audited by a large international audit firm (Big Four).	Dummy variable: 1 = audited by a Big Four audit firm (KPMG, Ernst & Young, PricewaterhouseCoopers, Deloitte); 0 = audited by non-Big Four audit firm.	Nominal (Dummy)

The regression model is specified as follows:

$SPIV_{i,t} = \alpha + \beta_1*TENURE_{i,t} + \beta_2*BIG4_{i,t} + \beta_3*VOL_{i,t} + \beta_4*GC_{i,t} + \beta_5*CLIENTIM_{i,t} + \beta_6*SIZE_{i,t} + \beta_7*ROA_{i,t} + \beta_8*LOSS_{i,t} + \beta_9*LEV_{i,t} + \beta_{10}*MB_{i,t} + \beta_{11}*AGE_{i,t} + \beta_{12}*SEG_{i,t}$ + year and industry fixed effect + $\varepsilon_{i,t}$

where:

$SPIV_{i,t}$ = denotes idiosyncratic stock price volatility.
α = represents the regression constant.
$TENURE_{i,t}$ = denotes auditor tenure as an independent variable.
$BIG4_{i,t}$ = denotes audit firm size as an independent variable.
$VOL_{i,t}$ = denotes trading volume as a control variable.
$GC_{i,t}$ = denotes the going concern opinion as a control variable.
$CLIENTIM_{i,t}$ = denotes client importance as a control variable.
$SIZE_{i,t}$ = denotes firm size as a control variable.
$ROA_{i,t}$ = denotes return on assets as a control variable.
$LOSS_{i,t}$ = denotes firm loss as a control variable.
$LEV_{i,t}$ = denotes leverage as a control variable.
$MB_{i,t}$ = denotes the market-to-book ratio as a control variable.
$AGE_{i,t}$ = denotes firm age as a control variable.
$SEG_{i,t}$ = denotes business segments as a control variable.
Year and industry fixed effects = represent dummy variables controlling for year- and industry-specific effects.
$\varepsilon_{i,t}$ = *denotes the error term.*

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Data Sources and Data Collection Techniques

Data that has already been collected is used in this study. Data on weekly stock returns is taken from finance.yahoo.com, while financial statements and audit reports are retrieved from the respective company websites and the Indonesia Stock Exchange (www.idx.co.id). The observation period encompasses the years 2013–2017, when financial data is collected.

Population and Sample

Included in its membership are all businesses that had an Indonesia Stock Exchange listing between 2013 and 2017. Using a purposive sampling technique, the sample is selected based on the following criteria:

Table 1 Sample Selection Criteria

Sample Selection Criteria	Number of Firms
Firms listed on the Indonesia Stock Exchange (IDX) during 2013–2017	473
Less: Financial sector firms (banking, insurance, and other financial institutions)	(50)
Less: Firms with incomplete financial or audit data	(28)
Less: Firms with missing weekly stock price data	(62)
Less: Delisted or suspended firms during the observation period	(49)
Observation period	5 years
Final firm-year observations	1,418

Data Analysis Technique

In order to analyze the data, this study used the multiple linear regression. We account for all relevant control variables and then use the regression model to assess the influence of auditing firm size and auditor tenure on idiosyncratic stock price volatility.

RESULT

The purpose of this study was to identify audit quality and idiosyncratic stock price volatility among non-financial publicly listed businesses on the Indonesia Stock Exchange from 2013 to 2017. As of the end of 2017, 473 non-financial enterprises were listed on the Indonesia Stock Exchange. Nonetheless, 1,418 observations each year make up the final sample; 2013 had 201, 2014 had 214, 2015 had 311, 2016 had 338, and 2017 had 354. All of this follows the guidelines laid out in the methodology section for selecting the sample.

Table 2. Presents the descriptive statistics of the research variables

Variables	N	Minimum	Maximum	Mean	Std. Deviation
SPIV	1418	-0.356	3.000	1.084	0.533
TENURE	1418	1	5.000	1.590	0.764
BIG4	1418	0	1	0.400	0.491
VOL	1418	0.0000000144	0.500	0.026	0.050
GC	1418	0	1	0.060	0.245
SIZE	1418	13.462	26.412	21.844	1.649
CLIENTIM	1418	0.000	1.000	0.119	0.231
ROA	1418	-70.470	71.600	3.733	9.320
LOSS	1418	0	1	0.220	0.414
LEV	1418	0.0000167	0.990	0.467	0.206
MB	1418	0	82.444	2.396	5.309
AGE	1418	1	37.000	13.990	9.024
SEG	1418	1	8.000	2.820	1.439

Descriptive statistics derived from 1,418 firm-year observations indicated that idiosyncratic

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stock price volatility (SPIV) had a mean value of 1.084 with relatively low variation. This suggests that the sample shows variation in firm-specific risk. About 40% of organizations are audited by one of the Big Four accounting firms. The average term of auditors is 1.59 years, which indicates that they rotate quite often. Companies ranging in size from medium to large make up the bulk of the sample. On average, these businesses have been around for over 14 years, and their operational diversification is moderate. When it comes to financial details, some businesses lost money (22%), while others had huge swings in profits and expansion prospects, and the percentage of audits that found the company to be solvent is still low. All things considered, there is enough diversity in audits and auditing firms in these numbers to test the hypothesis that auditor experience and auditing company size influence idiosyncratic stock price volatility.

Classical Assumption Tests

Specific classical assumption tests apply to the regression model to ensure it meets our requirements. From the P-P plot, we may infer that the data follow a normal distribution since the regression residuals are in line with the diagonal line (Figure 1).

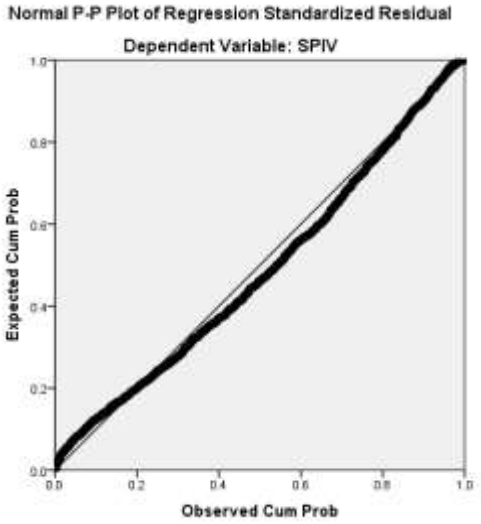

Figure 1. P – P Plot

There is no evidence of multicollinearity in the following variables (Table 3): audit firm size (BIG4), auditor tenure (TENURE), control variables trading volume (VOL), going concern (GC), client importance (CLIENTIM), firm size (SIZE), return on assets (ROA), loss (LOSS), leverage (LEV), market-to-book ratio (MB), firm age (AGE), and business segments (SEG).

Table 3 Multicollinearity Test

Model	Collinearity Statistics	
	Tolerance	VIF
TENURE	0.974	1.027
BIG4	0.686	1.458
VOL	0.917	1.091
GC	0.872	1.147
SIZE	0.701	1.426
CLIENTIM	0.858	1.166
ROA	0.504	1.982
LOSS	0.621	1.611
LEV	0.782	1.279
MB	0.772	1.295
AGE	0.800	1.251
SEG	0.865	1.156

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The variance inflation factor (VIF) values are less than 10, and all independent variables are significant except for audit firm size (BIG4) and auditor tenure (TENURE). When the scatterplot heteroskedasticity test confirms once again that the residuals are normally distributed and do not cluster, c is removed from the regression model (Figure 2).

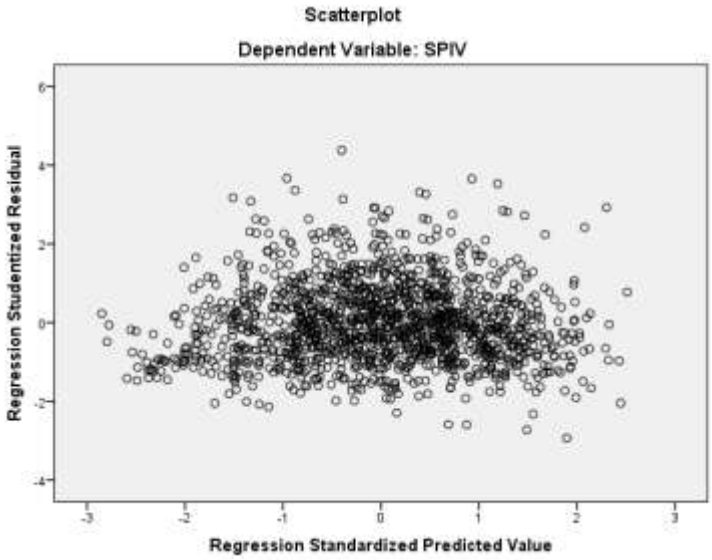

Figure 2. Heterokedastisitas Test

The regression model does not contain any autocorrelation, according to the findings of the autocorrelation test using the Durbin-Watson statistic. This is because the value of 1.905 is within the acceptable range of -2 to +2.

Model Analysis and Hypothesis Testing

The following are the outcomes of a multiple linear regression study that looked at how these independent variables: audit firm size, auditor tenure, going concern, client importance, firm size, ROA, loss, leverage, market-to-book ratio, firm age, and business segments relate to idiosyncratic stock price volatility.

$SPIV_{i,t} = 2{,}775 - 0{,}043\ TENURE_{i,t} - 0{,}055\ BIG4_{i,t} - 0{,}870\ VOL_{i,t} + 0{,}027\ GC_{i,t} - 0{,}079\ SIZE_{i,t} + 0{,}090\ CLIENTIM_{i,t} + 0{,}0003\ ROA_{i,t} + 0{,}057\ LOSS_{i,t} + 0{,}064\ LEV_{i,t} - 0{,}005\ MB_{i,t} + 0{,}0001\ AGE_{i,t} - 0{,}021\ SEG_{i,t} + \varepsilon_{i,t}$

Table 4. Multiple Linear Regression Analysis Results

Variables	Coeficient	t	P value	Conclusion
(Constant)	2.775	13.921	0.000	
TENURE	-0.043	-2.547	0.011**	Significant
BIG4	-0.055	-1.786	0.074*	Significant
VOL	-0.870	-3.286	0.001**	Significant
GC	0.027	0.495	0.620	Not Significant
SIZE	-0.079	-8.702	0.000***	Significant
CLIENTIM	0.090	1.534	0.125	Not Significant
ROA	0.000	-0.173	0.863	Not Significant
LOSS	0.064	1.660	0.097	Not Significant
LEV	0.050	0.728	0.467	Not Significant
MB	-0.005	-1.995	0.046*	Significant
AGE	0.000	0.088	0.930	Not Signifikan
SEG	-0.021	-2.238	0.025**	Significant
R square			0,213	
F statistic			17,685	
F sig			0.000	

Description:
* = statistically significant at a significance level of 10%
** = statistically significant at a significance level of 5%
*** = statistically significant at a significance level of 1%

Regression findings for audit firm size and auditor tenure are displayed in Table 4. The results suggest that auditor tenure is negatively correlated with idiosyncratic stock price volatility. The idiosyncratic volatility of the stock price reduces as the term of the auditor and client relationship increases, according to the negative and statistically significant coefficient of auditor tenure ($\beta = -0.043$; $t = -2.547$; $p = 0.011$). The results given here provide credence to Hypothesis H1, which posits that auditors who take the time to learn about their customers' businesses may be able to produce more reliable reports. Hypothesis H2 ($\beta = -0.055$; $t = -1.786$; $p = 0.074$) is supported by the fact that the size of the auditing firm has a significant and negative effect on idiosyncratic volatility. This finding suggests that stock values of companies that are audited by the Big Four are generally more stable.

This study found that trading volume ($\beta = -0.870$; $p = 0.001$), company size ($\beta = -0.079$; $p < 0.001$), market-to-book ratio ($\beta = -0.005$; $p = 0.046$), and the number of business segments ($\beta = -0.021$; $p = 0.025$) are the control variables that negatively affect idiosyncratic stock price volatility. These findings suggest that a robust operational diversification strategy, large business size, attractive growth prospects, and high stock liquidity all work together to lower firm-specific risk. Stock price volatility is unrelated to subjective metrics such customer importance, going concern, return on assets (ROA), loss, leverage, and age of the organization.

All control variables, auditor tenure, and audit firm size account for the remaining variation in stock price volatility, while factors outside the research model explain idiosyncratic volatility (modified R^2 value = 0.213). Taken together, these findings highlight the significance of auditor traits, such as engagement length and audit firm affiliation, in mitigating capital market risk associated with individual firms.

DISCUSSION

The Effect of Auditor Tenure on Idiosyncratic Stock Price Volatility

The findings indicate that longer auditor tenure is associated with lower idiosyncratic stock price volatility. This suggests that a longer auditor–client relationship improves the monitoring effectiveness of the audit process and enhances the credibility of financial reporting. As auditors accumulate client-specific knowledge over time, they develop a deeper understanding of the firm's operational environment, internal control systems, and financial reporting risks. This learning effect enables auditors to detect potential misstatements more effectively and to provide more reliable assurance regarding financial disclosures.

From a capital market perspective, improved financial reporting credibility reduces investors' uncertainty regarding firm-specific information. Prior studies argue that higher financial reporting quality is associated with lower idiosyncratic volatility because reliable information allows investors to evaluate firm fundamentals more accurately Rajgopal & Venkatachalam (2011) and Jorjani & Gerayeli (2018). When investors perceive audited financial statements as credible, they rely more on publicly disclosed information rather than attempting to obtain private firm-specific information.

These findings can be interpreted within the framework of the crowding-out effect proposed by Ferreira & Laux (2005). According to this perspective, improvements in disclosure quality and financial reporting credibility reduce investors' incentives to acquire private information because the marginal benefit of such information becomes lower. As a result, the incorporation of private firm-specific information into stock prices declines, leading to lower idiosyncratic stock price volatility. In this context, longer auditor tenure contributes to more reliable disclosures and reduces information asymmetry between managers and investors.

The Effect of Audit Firm Size on Idiosyncratic Stock Price Volatility

The results indicate that firms audited by larger audit firms, particularly the Big Four, tend to exhibit lower idiosyncratic stock price volatility. This finding suggests that the reputation and resources associated with large audit firms enhance the credibility of financial reporting and reduce uncertainty regarding firm-specific information. Large audit firms typically possess more advanced audit methodologies, stronger internal quality control systems, and greater reputational capital, which provide stronger incentives to maintain high audit quality. As a result, financial statements audited by Big Four firms are often perceived by investors as more reliable and informative.

The credibility of audited financial statements plays a critical role in reducing information asymmetry in capital markets. Prior research shows that improvements in financial reporting quality are associated with lower idiosyncratic volatility because investors can more accurately evaluate firm fundamentals and future performance (Rajgopal & Venkatachalam, 2011). When financial reporting becomes more transparent and reliable, firm-specific uncertainty decreases, leading to more stable stock price movements.

This result can also be interpreted through the crowding-out effect framework proposed by Ferreira & Laux (2005). Higher audit quality strengthens the credibility of publicly disclosed information, which reduces investors' incentives to acquire private firm-specific information. As the marginal benefits of private information acquisition decline, the role of private information in determining stock prices diminishes. Consequently, stock price movements become less influenced by firm-specific information trading, resulting in lower idiosyncratic stock price volatility.

Although some studies suggest that Big Four auditors may not always produce significantly more conservative financial reporting in certain institutional environments, the reputational signaling associated with Big Four auditors remains important for investor perception. In the Indonesian capital market, where information asymmetry and monitoring mechanisms may vary across firms, the presence of a reputable audit firm can serve as a signal of reporting credibility. This signal enhances investor confidence in disclosed financial information and contributes to lower firm-specific volatility in stock prices.

CONCLUSION

This study investigates the role of audit quality in explaining idiosyncratic stock price volatility among non-financial firms listed on the Indonesia Stock Exchange. The empirical results indicate that auditor tenure and audit firm size significantly reduce idiosyncratic stock price volatility. Longer auditor tenure allows auditors to develop a deeper understanding of client operations and financial reporting risks, thereby improving audit effectiveness. In addition, firms audited by Big Four audit firms exhibit lower firm-specific volatility, suggesting that higher audit quality enhances investor confidence in financial disclosures.

These findings contribute to the literature on audit quality and capital market efficiency by demonstrating that auditor characteristics play an important role in reducing firm-specific risk in emerging markets. Practically, the results provide implications for corporate governance and regulatory policies related to auditor selection and auditor rotation. However, this study has several limitations, including the limited observation period and the use of only two proxies for audit quality. Future research may extend the analysis by incorporating additional audit quality measures and exploring different market settings.

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