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Litigation Risk: Delving into Audit Quality, Internal Audit Structure, Political Connections, and Company Size

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ABSTRACT

This study investigates the impact of audit quality, internal audit organizational structure, political connections, and company size on litigation risk in the consumer goods industry sector listed on the Indonesia Stock Exchange during the period from 2017 to2022. A quantitative approach was used by applying Fixed Effects, Ordinary Least Squares, Random Effects, and Robust Regression analysis simultaneously to analyze panel data. The results showed that high audit quality serves as a significant positive signal in reducing the risk of lower litigation, providing confidence to stakeholders that financial statements can be more reliable and free from material misstatement. Meanwhile, a better internal audit organizational structure introduces complexity in the management of litigation risk as the organization grows, highlighting the possibility of more complicated implications in the context of signals, when internal audit placement does not fit the needs of the organization. Political connections and company size provide positive signals regarding litigation risk, albeit with different levels of significance, indicating complexity in the dynamics of political signals and company size. The findings of this study can guide stakeholders in the appointment of agents to manage the company.

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1. Introduction

The sustainability of an entity is a fundamental concern that has always guided policy direction and management practices (Chabrak, 2018). In the world of accounting, the concept of sustainability or "going concern" is a central tenet in financial planning and reporting (Abeysekera, 2022). This concept underscores how important it is for an entity to continue to exist, operate, and perform its functions in a changing business environment (Chi et al., 2009).

However, maintaining an entity, especially in a business context, is not an easy task (Kalbuana et al., 2022b). The entity will always face various challenges and risks that can threaten its survival (Hastomo et al., 2021; Kalbuana et al., 2023). One risk that is getting more attention is the litigation risk (Sun & Liu, 2011). Litigation risk refers to the possibility of lawsuits filed against an entity, either by internal or external parties (Crawford & Weirich, 2014), which may impact its reputation, finances, and business stability (Mustapha et al., 2021).

The importance of researching litigation risk lies in an in-depth understanding of the factors that can influence this risk (Wong et al., 2018). In this context, factors such as audit quality, internal audit organizational structure (Prasetio et al., 2021; Prasetyo, Aliyyah, Rusdiyanto, Kalbuana, & Rochman, 2021), political connections, and company size have an important role to play in managing litigation risk (Jung & Kim, 2019). Previous research highlights the importance of audit quality in reducing litigation risk (Jannah et al., 2020; Kalbuana et al., 2021). Audit quality is reinforced by the competence and specialization of auditors, which provide positive signals to stakeholders and reduce potential lawsuits (Taqi et al., 2020). Litigation risk can also threaten the continuity of a Public Accounting Firm (KAP) with an impact on its reputation and profitability (Endarto et al., 2021; Kalbuana et al., 2022a; Prasetyo, Aliyyah, Rusdiyanto, Utari, et al., 2021), prompting auditors to make extra audit efforts to reduce litigation risk (Ulfasari & Marsono, 2014).

Internal audits with appropriate status and competence within the organization have an important role in identifying and addressing potential fraud, thereby reducing the risk of fraud (Abadi et al., 2021; Indrawati et al., 2021; Prasetyo, Aliyyah, Rusdiyanto, Nartasari, et al., 2021a). The status of the appropriate organization supports the regulation for the placement of internal audit in a suitable organizational structure (Kalbuana et al., 2021; Luwihono et al., 2021; Prasetyo, et al., 2021b). Internal auditors work closely with high-quality audit committees to evaluate internal controls and ensure compliance with audit standards. The results of research by Mayanda and Wardhani, 2015 and Ozcelik, 2020 show that the appropriate audit committee status negatively affects the risk of fraud and litigation, indicating that attention to the status of internal audit organizations can reduce litigation risk (Aliyyah, Siswomihardjo, et al., 2021; Kalbuana et al., 2022).

Large auditors often have clients that are large companies, which tend to face more complex lawsuits (Rahman & Apandi, 2020). As a result, large auditors tend to be more cautious in providing their audit services to safeguard their reputations. Accounting scandals are often carried out by company management to increase profitability and attract investors or obtain credit facilities (Rizki & Sudarno, 2020). Therefore, companies with low litigation rates can be considered to have received high-quality audit services from their Public Accounting Firms. Although large companies have more resources to address litigation risks, they can also be the target of more frequent lawsuits due to their large size and operational complexity (Amami & Triani, 2021).

Political connections in a business context can have an impact on a company's litigation risk. While having political connections can provide a number of advantages, such as greater access to government financing, increased procurement of government contracts, protection from market competition, and favorable regulatory treatment, it can also pose significant litigation risks. Strong political connections can create incentives for company directors and management to act unethically, potentially through actions that violate ethical standards or the law. In addition, close political relationships often result in patron-client dynamics, in which companies must comply with the wishes or requests of the ruling political leader. If corporate actions directed by these political connections prove to be unlawful or ethical, the risk of litigation may increase significantly (Aliyyah, Prasetyo, et al., 2021). Therefore, it is important to understand that while leveraging political connections can yield business benefits, companies also need to mitigate litigation risks that may arise from those political relationships.

The scope of this research encompasses companies actively operating in the consumer goods industry sector and listed on the Indonesia Stock Exchange during the period from 2017 to 2022. The selection of companies within this sector is based on their high relevance to the research objectives. Our focus lies on large, industry-leading companies actively engaged in various initiatives to attract investors, possessing traded stocks characterized by high liquidity and market capitalization.

In this study, our primary objective is to contribute to existing knowledge through a comprehensive analysis of litigation risk. Our distinctive approach integrates key factors, namely audit quality, internal audit structure, political connections, and company size. This integration provides a novel perspective on litigation risk, an aspect not extensively explored in previous research. By examining the interplay of these elements, we aim to uncover new insights and deepen our understanding of the dynamics influencing litigation risk in the corporate landscape. Our research introduces a novel framework, shedding light on the intricate relationships between audit quality, internal audit structure, political connections, company size, and the likelihood of litigation.

2. Literature Review and Hypotheses

2.1. Signal Theory

Signal Theory is a highly relevant concept in the world of finance and business that focuses on information management. This theory requires the existence of a message, the sender and receiver of the message, and a feadback. In this study, the sending party is the company's management and the recipient is the investor, while the message is a company with low litigation risk and the expected feadback is the investor's positive response to low litigation risk (Suryaningsih et al, 2023).

This theory arises from the presence of information asymmetry, which means that in a given situation, the parties involved in the transaction have an unbalanced level of information. In a financial context, this often happens between company management and investors or shareholders. Signal Theory explains that company management will use various signals or signs to communicate information about the company's performance to interested parties. These signals can be actions, announcements, or company policies that can give insights into the company's condition. It takes a strong signal to be captured and responded to (feedback) by the signal receiver. Strong signals, such as the announcement of an increase in profits, aim to attract investors by showing good performance. The expected feedback from the signal is a positive response from investors to buy shares of companies that have an impact on rising stock prices. On the other hand, signals such as restructuring announcements can be used to mitigate the impact of negative information on stock prices. Investors' reactions to these signals can then influence their stock prices and investment decisions (Prasetyo et al., 2021b; Prasetyo et al., 2021).

2.2. Conceptual Framework for Research

The objective of this research endeavor is to examine the impact of four independent variables, namely Audit Quality, Internal Audit Organizational Structure, Political Connections, and Company Size on litigation risk, which is specific to the organization (Taqi et al., 2020). Audit Quality reflects the extent to which audits by external auditors are conducted in accordance with applicable audit standards (external factors), and Internal Audit Organizational Structure which refers to the position and competence of internal auditors in the organizational hierarchy (internal factors), as well as Political Connections which describe the company's relationship with political parties and government officials that can influence decisions and regulations (external factors), and Company Size which reflects the scale operations and complexity of the enterprise (internal factors) (Endarto et al., 2021; Uzliawati, Kalbuana, et al., 2023; Uzliawati, Taqi et al., 2023).

In this conceptual framework, we assume that those independent variables can have a positive or negative influence on the dependent variable, i.e. Litigation Risk. This study aims to identify the extent to which these internal and external factors contribute to the level of Litigation Risk in businesses listed on the Indonesia Stock Exchange in the consumer goods industry sector between 2017 and 2022. Based on the explanation above, the conceptual framework of the research can be depicted as follows:

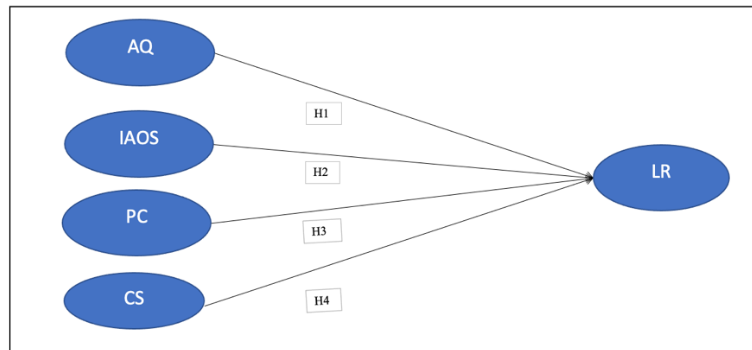

Fig. 1. Research Conceptual Framework

2.3. Research Hypothesis

2.3.1. The Effect of Audit Quality on Litigation Risk

The auditor's inability to assess the risk of fraud has become a serious problem, especially when most cases of fraud are detected after the auditor has audited the financial statements. Litigation may potentially ensue due to the acceptance of questionable clients accompanied by a compromised integrity. With the advancement of audit quality, the likelihood of litigation decreases. In order to mitigate the occurrence of litigation, auditors tasked with auditing must possess expertise and proficiency in the designated industry, employ their professional capabilities to deliver audits of exceptional quality, and communicate to stakeholders that their audits surpass elevated standards (Taqi et al., 2020).

The continuity of a public accounting firm is threatened if it experiences audit failure, resulting in significant losses due to the litigation risks faced. A public accounting firm will lose its reputation and probability advantage in its audit services. Therefore, the auditor will be more careful and try to overcome the risk of litigation with extra audit efforts, thereby minimizing the threat of litigation that may be directed at them by interested parties (Ulfasari & Marsono, 2014).

To reduce the likelihood of company litigations, the auditor (KAP) is required to communicate to stakeholders, in accordance with signaling theory, that the audit they conduct is of high quality. A quality audit process ensures the accuracy of the information presented in the financial statements and reduces information asymmetry between the company and investors. The existence of several litigation cases behind this study formed the initial perception that the high number of litigation cases was due to the low quality of audits (Taqi et al., 2020).

Previous research has examined how audit litigation affects audit quality, moderated by ownership structure (Abdullah & Ani, 2021). In that study, the results indicate that audit quality is a sensitive issue for Big 4 audit firms and their clients, where audit quality will decline if the size of audit litigation against Big 4 audit firms increases. This research demonstrates an insignificant effect of audit litigation on the ownership structure of Omani companies listed on MSM for both types of clients.

In contrast to previous research, this study examines the reverse direction, assessing the impact of audit quality on litigation. Sun and Liu (2011) found that the difference in audit quality between the Big 4 and non-Big 4 is more pronounced when client-specific litigation risk is high. The effectiveness of Big 4 auditors compared to non-Big 4 auditors in limiting profit management is greater for clients with high litigation risk than for those with low litigation risk (Rahmah & Apandi, 2020), indicating that high client litigation risk can compel large auditors to work more effectively (Pendi et al., 2023). In addition, research conducted by AL Abdullah and AL Ani (2021); Jung and Kim (2019); Taqi et al. (2020), and Wong et al. (2018) shows that audit quality has a significant negative effect on litigation. Based on the above description, the hypothesis for this study can be stated as follows:

$H_{1:}$ Audit quality negatively affects litigation

2.3.2. The Effect of Internal Audit Organizational Structure on Litigation Risk

Internal auditors are more likely to execute adequate anti-fraud operations when they have the proper status within the organization and the necessary competencies. It is critical for regulators to mandate that the status of internal audits in financial services be established in accordance with the needs of the firm.

An effective internal auditor can support an organization in achieving its goals and protecting its assets and funds. However, to be effective, internal auditors need to be empowered with relevant resources (Alqudah et al., 2023). The research findings (Alqudah et al., 2023) indicate that management support, cooperation with external auditors, independence, and extrinsic rewards significantly influence the effectiveness of internal auditors.

Direct research conducted by Lari Dashtbayaz et al. (2022) shows a significant difference in the impact of internal control weaknesses on the types of auditor opinions between companies involved in fraud and those not involved. The results also indicate that the relationship between internal control weaknesses and types of auditor opinions remains significant in both types of companies, providing concrete support for the hypothesis argument.

In contrast to previous research, this study examines the influence of the internal audit organizational structure on litigation risk. The audit agency along with a qualified audit committee will evaluate the ongoing internal control structure, implement the internal audit in accordance with applicable audit standards, and ensure follow-up on audit findings so that litigation risks can be minimized. Research by Mayanda and Wardhani (2015) and Ozcelik (2020) shows that the relative status of the audit committee has a negative, significant effect on the risk of fraud and litigation. Based on the description above, the author hypothesizes that:

H_2: The status of the internal audit organization negatively affects Litigation Risk

2.3.3. The Influence of Political Connections on Litigation Risk

Companies with political ties in Indonesia tend to choose less certified auditors, where political communication plays an important role, and policy-affiliated companies deal with significant affiliates to hide their rental and tunneling activities (Habib et al., 2017). There may be significant motivations for businesses with political ties to minimize objections to the portrayal of political linkages. Politically connected businesses might have substantial motivations to minimize objections to the portrayal of political relations.

Khaksar et al., (2022) conducted a study evaluating the relationship between political connections, audit quality, and auditor industry expertise. The research findings indicate a significant and negative relationship between political connections and audit quality and expertise, implying that companies with high political connections increase competition in the audit market and lower audit quality.

Research examining the relationship between political connections, board interlock, and financial reporting quality has been conducted by Salehi et al. (2021). The results show a significant and negative relationship between political connections, board interlock, and financial reporting quality. Thus, higher political connections reduce financial reporting quality.

Salehi (2020) investigated the correlation of a company's political connections with auditor selection, audit fees, and abnormal audit fees. The research results indicate a positive and significant correlation between a company's political connections and the selection of certified auditors, audit fees, and abnormal audit fees. Additionally, the company's political connections have a significant and inverse influence on the relationship between institutional ownership and audit fees, as well as abnormal audit fees. It was also found that there is a positive and significant correlation between companies with political connections and abnormal audit fees.

Research by Lal Josh and Karyawati Purba (2022) shows that key factors influencing the effectiveness of internal auditing in Indian companies include the competence of internal audit staff and the interaction of internal auditing with the audit committee. The results confirm that institutional theory best explains the effectiveness of internal auditing in India. These findings encourage audit professionals to develop their core competencies to provide efficient services, emphasizing that continuous interaction with audit committee members can enhance organizational focus through improved internal audit effectiveness.

In contrast to previous research, this study examines the influence of political connections on litigation risk. Political connections have a positive and significant influence on the litigation risk (Matangkin et al., 2018). Similarly, research conducted by Sabrina et al. (2020) showed that corporate governance of organizations with political connections affects fraudulent financial reporting. This

statement is in line with research conducted by Kurnia and Anis (2017), which states that political relations or political connections affect financial statement fraud. Companies with political connection will affect the level of indication of fraudulent financial statements due to the advantages of political connection and conflicts and pressure from internal and external parties of the company (Putra & Wobowo, 2021). Based on the description above, the hypothesis in this study can be formulated as follows:

H_3: Political connections positively affect litigation risk

2.3.4. The Effect of Company Size on Litigation Risk

Generally, large auditor clients are companies with significant size, so the lawsuits faced by their clients will be more complex. Accordingly, auditors will be more careful in providing audit services to maintain their reputation (Rahman & Apandi, 2020). Scandals in accounting are mostly perpetrated by company management in order to boost the amount of profits obtained by the company, so that shares of the company can look attractive and seem profitable to be bought by investors on the stock exchange or to get credit facilities (Rizki & Sudarno, 2020). If a company has a low litigation rate, one can conclude that KAP conducts high-quality audits (Wooten, 2003). A large company will be able to find better and more meaningful ways to avoid market risk and uncertainty and also have a better chance of avoiding losses (Ratnawati et al., 2018).

In the context of signaling theory, lawsuits are negative signals because they can incur expensive costs and adversely affect the company's operating profit, as they are recognized as an expense. Litigation also leads to the use of company funds for case resolution rather than being used in business operations that can generate profits for the company (Amami & Triani, 2021).

Based on research conducted by Dumas et al. (2015), there is no evidence that the size of the company can increase the likelihood of judicial success (in this case litigation). However, the larger companies tends to devote more resources in terms of human capital to a particular case, thereby increasing the likelihood of a favorable outcome. Additionally, based on research on the effect of company size on audit quality conducted by Buchori and Budiantoro (2019), company size has a positive effect on audit quality. Based on the description above, the hypothesis in this study can be formulated as follows:

H_4: Company size positively affects litigation risk

3. RESEARCH METHODS

3.1. Types and Approaches to Research

This research is associative quantitative research using secondary data available at https://www.idx.co.id. IDX-listed companies in the consumer products industry subsector constitute the population for this study. The sample for this research comprises a sub-sector businesses in the consumer products industry that were listed on the Indonesia Stock Exchange between 2017 and 2022. Purposive sampling techniques were employed, using certain criteria for selection: (1) Companies operating in the consumer goods industry sector that were continuously listed on the Indonesia Stock Exchange from 2017 to 2022; (2) Companies that issue annual reports and provide consecutive audited financial statements throughout the observation period; (3) Companies that explicitly include audit costs in the annual report during the observation period. This study's panel data analysis approach makes use of the Robust, Random, Fixed, and Ordinary Least Squares regression models, all of which are run concurrently with Stata software.

3.2. Operational Definition and Measurement

Audit Quality, Internal Audit Organizational Structure, Political Connections, and Company Size are independent when the dependent variable is Litigation Risk.

3.2.1. Independent variable

Independent variables possess the ability to influence other variables. This study uses the variables of Audit Quality, Internal Audit Organizational Structure, Political Connections, and Company Size as independent variables:

a) Audit Quality (AQ)

Studies conducted by Yasin and Nelson (2012) propose the use of audit costs as an indicator of audit quality. They state that higher audit costs reflect the existence of more efficient audit services provided by auditors to companies. This view is in line with that ofO'Sullivan) (2000), which posits that more in-depth investigations require more audit hours and dedicated audit staff, which in turn contributes to higher audit costs. Audit quality is proxied by:

AQ= log Audit fee

b) Internal Audit Organizational Structure (IAOS)

Determining the status of an internal audit organization is conducted by examining the company's organizational structure and identifying where the internal audit is positioned within that structure. This variable is measured based on the concept suggested by Agoes (2017), and we design the measurement as follows:

Description	Scale
Internal Audit is the President Director's staff	1
Internal Audit is under the Director of Finance	2
Internal Audit is under The President Director & Staff of the Board of Commissioners	3

c) Political Connection (PC)

Companies that have political connections are defined as those that, under the exclusive rule, maintain political ties or seek connections with the government or politicians (Sulistyowati & Prabowo, 2020). Companies are defined as politically connected if one of the company owners, board of commissioners, or board of directors has served or is currently an official in the government, military officials, or parliamentarians during the research period (Supiandi, 2019). To assess political connections, this study used dummy variables: companies that have been established to have such links are assigned a value of 1, whereas those devoid of such connections are assigned a value of 0.

d) Company Size (CS)

Company size is one of the factors that can affect the internal audit organizational structure. The larger the size of the company, the greater the scope of supervision that must be carried out, and it requires great authority as well. The positioning of internal audit within the organizational structure will undergo modifications in tandem with the progress of the company and the requirement to oversee the efficacy of current controls. The size of the company is proxied by:

CS= log total assets

3.2.2. DependentVariable

Dependent variables are defined as those variables whose value cannot be influenced by other variables. The dependent variable in this research is Litigation Risk. Litigation can occur due to business failure, audit failure, and audit risk. Litigation against the public accountant occurs if negligence arises or the public accountant is caught in fraud. The negligence or violation in question can take the form of ordinary negligence, gross negligence, constructive fraud, and fraud (Agoes, 2017).

$$LR = Size + \frac{Non\,current\ liability}{Total\ assets} + \frac{Current\ liability}{Current\ assets}$$

3.3. Data Analysis Techniques

Data analysis aims to quantitatively measure the effect of changes of one variable on other variables, as well as to predict or estimate events that may occur subsequently. The process of data analysis involves a number of steps, including data processing to address problems such as missing values, as well as the use of statistical techniques and hypothesis testing to evaluate the underlying assumptions of the study. The results of this data analysis not only provide a deeper understanding of the relationships between the variables studied, but also allow researchers to make projections or forecasts related to the phenomenon being investigated within the research framework.

3.3.1. Descriptive Statistics

Audit Quality, Internal Audit Organizational Structure, Political Connections, Company Size, and Litigation Risk variables are examples of descriptive statistics that can present a comprehensive understanding of the research topic by means of data analysis, while omitting the examination of specific factors..

3.3.2. Pearson Correlation Test

The Pearson correlation test is a statistical tool used to investigate the relationship between two variables: the dependent and independent variables. This analysis assumes the data to be normally distributed. The results of this test produce a correlation value that can be positive (+) or negative (-). When the correlation value is positive, it indicates that the two variables have a direct link. That is, when the value of the independent variable rises, so does the value of the dependent variable. If the correlation value is negative, it shows that the two variables have a one-way relationship. In this scenario, as the value of the independent variable rises, so does the value of the dependent variable. Correlation values are always in the range of 0 to 1, with 0 indicating no correlation and 1 indicating perfect correlation between the two variables. The pearson correlation is calculated using the following formula:

$$r_{xy} = \frac{n\sum XY - (\sum X)(\sum Y)}{\sqrt{\{n\sum X^2 - (\sum X)^2\}\{n\sum Y^2 - (\sum Y)^2\}}}$$

where:

r = Correlation value
X = Variable X
Y = Variable Y

3.3.3. Research Regression Model

Regression is a statistical technique utilized to determine the degree of correlation between two or more variables. It allows us to predict or forecast the value of an independent variable (Y), when the dependent variable (X) undergoes a change. Panel data regression analysis was employed in this investigation, which is a useful statistical method to examine the effect of independent variables such as Audit Quality, Internal Audit Organizational Structure, Political Connections, and Company Size on Litigation Risk. The equation model used for this analysis is

$$LR_{i,t} = \beta_0 + \beta_1 QA_{i,t,} + \beta_2 SOIA_{i,t} + \beta_3 CP_{i,t,} + \beta_4 FS_{i,t} + \mathcal{E} \quad (1)$$

The model helps us understand how these variables interact and influence Litigation Risk through the following explanation:

Table 1. Variable Description

Detail		Description
i	=	Cross-sectional company data
t	=	Time series company data
LR	=	Litigation Risk
QA	=	Quality Audit
SOIA	=	Internal Audit Organizational Structure
CP	=	Political Connection
FS	=	Firm Size
α	=	Constant
β_1, β_2, β_3, β_4	=	Regression coefficients of variables QA, SOIA, CP, FS
ϵ	=	Error

4. RESULTS AND DISCUSSION

4.1. Descriptive Statistics of Variables

Statistical data can be accompanied by the minimum, maximum, mean, and standard deviation of the variables under investigation from the sample of companies. The information in the table below pertains to the consumer goods industry and is derived from a sample of businesses listed on the Indonesia Stock Exchange during the period from 2017 to 2022.:

Table 2. Descriptive Variables

Variables	Obs	Mean	Std. Dev.	Min	Max	p1	p99	Skew.	Kurt.
LR	84	13.268	.798	11.665	15.03	11.665	15.03	.298	2.662
KA	84	8.979	.413	8.342	9.886	8.342	9.886	.439	2.268
SOAI	84	1.536	.911	0	3	0	3	.471	2.133
CP	84	1.333	1.417	0	4	0	4	.7	2.253
SIZE	84	12.518	.627	11.203	13.435	11.203	13.435	-.066	1.738

The output table illustrates the descriptive statistical results of the study sample, consisting of 84 observations. The variables observed include Litigation Risk (LR), with a minimum value of 11.665 and a maximum of 15.03, an average of 13.268, and a standard deviation of 0.798. Audit Quality (KA) ranged from 8.342 to 9.886, with an average of 8.979, and a standard deviation of 0.413. The Internal Audit Organizational Structure (SOAI) ranges from 0 to 3, with an average of 1.536, and a standard deviation of 0.911. Political Connections (KP) range from 0 to 4, with an average of 1.333, and a standard deviation of 1.417. Firm Size (FS) ranges from 11.203 to 13.435, with an average of 12.518, and a standard deviation of 0.627. The results of the analysis show that the distribution of data for this variable has certain characteristics, such as skewness that shows a positive slope in some specific variables, which will be the basis for further analysis in this study.

4.2. Pearson Correlation Test

Analysis is performed in the context of Pearson correlation testing to determine the degree of association between independent variables, namely Audit Quality, Internal Audit Organizational Structure, Political Connections, and Company Size, with the dependent variable, namely Litigation Risk. The assessment of the strength of this relationship is based on the value of the Pearson correlation coefficient (r). If the r value exceeds the significance level of 0.05 (5%), the association between the independent variable and the dependent variable can be judged to be strong. However, if the value of r is below that level of significance, the relationship between independent and dependent variables is then regarded as weak.

Table 3. Pearson Correlation Test

Variables	(1)	(2)	(3)	(4)	(5)
(1) LR	1.000				
(2) KA	0.608	1.000			
	(0.000)				
(3) SOAI	-0.122	0.002	1.000		
	(0.269)	(0.982)			
(4) CP	0.628	0.552	-0.028	1.000	
	(0.000)	(0.000)	(0.800)		
(5) FSIZE	0.843	0.745	-0.319	0.547	1.000
	(0.000)	(0.000)	(0.003)	(0.000)	

Variables	(1)	(2)	(3)	(4)	(5)
(1) LR	1.000				
(2) KA	0.608*	1.000			
(3) SOAI	-0.122	0.002	1.000		
(4) CP	0.628*	0.552*	-0.028	1.000	
(6) FSIZE	0.843*	0.745*	-0.319*	0.547*	1.000

*** p<0.01, ** p<0.05, * p<0.1

The findings presented in the table indicate that all variables, including Audit Quality, Internal Audit Organizational Structure, Political Connections, Company Size, and Litigation Risk, have reliability values above the significance level of 0.05 (5%). These results indicate that all of these variables can be

considered valid and trustworthy in model testing. In addition, the results of reliability testing confirm that all of these variables have a good level of reliability and are suitable for use in this study.

4.3. Goodness of Fit Model Testing

Testing the hypothesis is significant in research since it helps define the level of scientific rigor of the work. Based on four regression tests (Ordinary Least Square, Fixed Effects, Random Effects, and Robust), the scientific viability of the model was assessed. The output results were as follows:

Table 4. Goodness of Fit Model

VARIABLES	**(Models 1) OLS**	**(Models 2) Fixed Effects**	**(Models 3) Random Effects**	**(Models 4) Robust**
KA	-.431*	- .319	.216	-.431*
	(.168)	(3.038)	(.162)	(.257)
	0.012	0.000	0.183	0.008
SOAI	.161**	-.064	.011**	.161*
	(.053)	(.114)	(.054)	(.068)
	0.003	0.018	0.839	0.020
CP	.138***	-.004	.026	.139***
	(.037)	(1.886)	(.047)	(.028)
	0.000	0.685	0.582	0.000
FSIZE	1.187***	1.572***	1.206*	1.187***
	(.118)	(.715)	(.149)	(.165)
	0.000	0.060	0.000	0.000
Constant	. 1.847	-9.176***	-3.813*	1.847
	(1.164)	(2.194)	(1.712)	(.115)
Observations	84	84	84	84
R-squared	.783	.633		.783
Count of the Year		5	5	
Country Fixed Effects		Yes		
Country Random Effects			Yes	

Parenthetical standard errors*** p<0.01, ** p<0.05, * p<0.1

4.4. Discussion of Research Results

4.4.1. The Effect of Audit Quality on Litigation Risk

Audit Quality displays negative coefficient estimates in line with the original theory. The t-test results clarify that, in three models, Audit Quality has a substantial negative impact on Litigation Risk, with respect to the p-value significance threshold of 0.000 < 0.05 (5 percent) in three models (OLS, FE, and Robust). The empirical test results demonstrate that an increase in Audit Quality is associated with a decrease in litigation risk, whereas conversely, a decrease in Audit Quality is linked to an increase in litigation risk. These empirical findings support the results of research conducted by AL Abdullah andAL Ani (2021); Jung and Kim (2019); Taqi et al. (2020); Wong et al. (2018), which indicate that audit quality has a negative influence on litigation risk; thus, the hypothesis is accepted (p-value 0.000 ≤ 0.05 (5%).

In the perspective of signal theory, these findings suggest that high audit quality will result in financial statements that are free from material misstatement and minimize litigation risk , whichcan be interpreted as manifestations of strong signals in information communication. Higher audit quality serves as a positive signal that reduces uncertainty and reinforces stakeholders' confidence, especially among shareholders, that financial statements are reliable, and litigation risk has been properly managed. These results reflect the importance of audit quality as a control mechanism that can provide confidence and reduce uncertainty for stakeholders in decision-making and monitoring of company performance. They also suggest that the role of signals in litigation risk management has become crucial in today's business environment.

4.4.2. The Effect of Internal Audit Organizational Structure on Litigation Risk

The Internal Audit Organizational Structure shows that the results of the positive coefficient estimation are different from the initial hypothesis. The t-test results demonstrate that, in all three models, the Internal Audit Organizational Structure significantly and favorably affects Litigation Risk at the statistical significance of the p-value level of 0.003 ≤ 0.05 (5 percent) (OLS, FE, and Robust).

The empirical test results show that the internal audit organizational structure affects litigation risk and vice versa. The risk of litigation increases with the internal audit organizational structure. These empirical results contradict the conclusions of studies conducted by Mayanda and Wardhani (2015) and Ozcelik (2020), which found a substantial negative impact of the Internal Audit Organizational Structure on litigation risk.

These findings suggest that a better internal audit organizational structure can be considered a strong signal in information communication and supervisory activities. However, what is interesting is that a strong internal audit organizational structure actually indicates a heightened chance of litigation. This shows the complexity of the dynamics between factors affecting litigation risk. . These findings emphasize the need for a deeper understanding of the role of internal audit, where there is a paradigm shift in internal audit from watchdogs to consultants and continuous improvement. These changes require internal auditors to participate more actively in the implementation of operational activities, provide consultations, and improvise rather than simply supervise. This condition impacts weak supervision and increased complexity of litigation risk caused by heightened audit risk (control risk). This situation has the potential to create contradictions between initial expectations and empirical findings.

4.4.3. The Influence of Political Connections on Litigation Risk

The first hypothesis states that political connections display positive coefficient estimation outcomes. At the level of significance, the p-values are 0.000 ≤ 0.05 (5 percent) in OLS and Robust models, 0.685 ≥ 0.05 (5 percent) in Fixed Effects models, and 0.582 ≥ 0.05 (5 percent) in Random Effects models. The t-test results clarify that Political Connection has a positive but insignificant effect on litigation risk. According to the results of the empirical test, there is a positive correlation between political connection and litigation risk; conversely, a negative correlation exists between political connection and litigation risk. These empirical findings support the results of research conducted by Kurnia and Anis (2017); Matangkin et al. (2018); Putra and Wobowo (2021); Sabrina et al. (2020), which indicate that political connections have a positive influence on litigation risk.

These findings suggest that political connections can be perceived as signals that indicate political relationships and influence within the corporate environment. While the t-test results show insignificance, the findings still suggest that the presence of political connections may signal an increase in litigation risk. This could mean that stakeholders, especially investors and regulators, may be more likely to be wary of litigation risk in situations where there are political connections, even though the actual impact has not yet reached a level of significance in testing. This highlights the complexity of measuring the impact of political connections in litigation risk management, and further research is needed to understand these dynamics more deeply.

4.4.4. The Effect of Company Size on Litigation Risk

In line with the original hypothesis, the size of the company shows positive coefficient estimation. A t-test shows that the size of the company has a positive and significant effect on litigation risk, with a p-value of 0.000 to 0.05 (5%) in the OLS, Random effect, and Robust models, and ≤ 0.060 to 0.05 (5%) in the Fixed Effects models. The empirical test results demonstrate that the incidence of lawsuits goes up as the company size increases, and the incidence of lawsuits goes down as the company size decreseas. These empirical results support the idea that the size of the company has a positive effect on the Litigation risk. The accepted hypothesis (p-value 0.005 ≤ 0.05 (5%) is in line with Buchori and Budiantoro (2019).

These findings are supported by signal theory. In this context, firm size can be thought of as a signal of firm's complexity, risk exposure, and responsibility. The findings indicated a positive correlation between the scale of an organization and its susceptibility to litigation risk.. This indicates that the size of the company signals to stakeholders that litigation risk may be higher within larger companies. This is also in line with the results of previous studies. These findings highlight the importance of effective litigation risk management in large companies and that stakeholders may be more inclined to closely monitor and supervise larger companies.

5. Conclusions and Implications of Research Results

The results of this study imply that signals such as audit quality, internal audit organizational structure, political connections, and company size play an important role in the management of litigation risk. Higher audit quality signals lower litigation risk. This indicates that quality audit practices provide confidence to stakeholders that financial statements are reliable and litigation risk is well managed. A better internal audit organizational structure correlates with increased litigation risk, emphasizing complexity in the role of the internal audit organizational structure in managing litigation risk. Political connections are numerous signals of the many litigation risks that will be faced, and they suggest that stakeholders may be more likely to pay attention to litigation risks in the context of political connections, even though their impact has not yet reached a level of significance in testing. The larger the size of the company, the higher its exposure to litigation risk, which illustrates that a large company size indicates greater problem faced and a greater risk of litigation. The large size of the company signals the amount of litigation risk that will be faced.

Overall, these findings provide important insights for companies into managing litigation risk, and further research can help deepen the understanding ofthe complex dynamics between these signals and litigation risk in changing business contexts.

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