Auditor Characteristics, Audit Tenure, Audit Fee and Audit Quality

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ABSTRACT

Objective – The purpose of this research is to obtain empirical evidence about the factors that affect audit quality for auditors working in Public Accounting Firms in DKI Jakarta.

Methodology/Technique – The independent variables used in this research are: independence, work experience, competency, accountability, audit tenure, and audit fee. The object of this research consists of 25 Public Accounting Firms located in DKI Jakarta. There are 164 respondents used as samples in this study. The sample was selected based on a convenience sampling method with criteria including auditors working at public accounting firms located in DKI Jakarta, with a minimum of one year work duration. This research used statistical tests of multiple regression.

Findings – The result shows that independence, accountability, and audit tenure have an effect on audit quality. Meanwhile, work experience, competency, and audit fees have no influence on audit quality.

Novelty – The study suggests that to improve audit quality, Public Accounting Firms should pay attention to the independence and accountability of its auditors.

Type of Paper: Empirical

Keywords: Audit Quality; Independence; Work Experience; Competency; Accountability; Audit Tenure; Audit Fee.

JEL Classification: M41, M42.

1. Introduction

The financial statements contain information used in decision-making by both internal and external parties. External parties use reliable financial reports of a company's management to monitor the money they have invested. The need for reliability of the information in financial statements is what drives the need for third party auditors to provide confidence in the truth of the financial statements to investors and creditors (Agusti & Pertiwi, 2013). Public confidence, especially that of the users of financial statements which have been audited by the auditors, provides an incentive for public accountants to pay adequate attention to the quality of services they are providing. High quality audits are an assurance that the financial statements accurately depict the actual financial condition of the company (Saripudin et al. 2012).

Instances of fraudulent financial reporting involving a Public Accounting Firm (KAP) do occur. This causes many people to doubt and call into question the quality of a company’s audits as well as the performance of auditors in dealing with their clients. This makes auditing of financial statements an especially important task, as the audit quality acts as a benchmark of trust in the company. Augustine et al. (2014) states that users of

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financial statements believe that high audit quality is greater assurance that there is no material misstatement in the financial statements. Consequently, an auditor considers that a high quality of audit demonstrates that they have satisfactorily completed their duties. Further, the regulator considers high audit quality as representing financial statements that have been audited in accordance with professional standards. In the end, the public realizes that a high quality audit becomes a way to prevent economic problems for the company. Thus, this study would like to examine the factors that affect audit quality, so that auditors can improve the quality of their audits. Independence, work experience, competence, and accountability were identified as characteristics of the auditor that had the potential to improve the audit quality. Audit tenure relates to the duration of the auditor in conducting an audit of a company, and audit fees are all expenses incurred by the company, paid to the external auditors of audit and non-audit services provided by the auditors.

Agency theory is a theory that explains the existence of potential conflicts of interest between management as an agent with shareholders as principal (Jensen & Meckling 1976). Conflicts of interest arise from the fact that the management of a company wants to bolster their appearance as it appears in the financial statements, so that they may appear more appeasable to the readers of those statements, especially the owner of the company (the principal). However, the principal of a company wants the financial statements to report the real financial situation of the company so that the information attained can be used as reference in decision making. This difference of interests between management and the users of these financial statements mandates the examination of financial statements by an independent party (i.e. the auditor) to detect and minimize fraud. Agency theory is used to assist the auditor to understand these conflicts that may arise between the principal and the agent. The external auditor acts as a mediator of those interests and has a duty to evaluate and make judgments regarding the fairness of the financial statements presented by management based on applicable industry standards (Ratha & Ramantha, 2015).

Arens et al. (2014) states that independence is the most important characteristic to be possessed by an auditor in conducting an audit. According to Kurnia (2014), independence is an attitude of the auditor which enables them to maintain their findings and prevents them from being influenced by either the client or other parties who have an interest in the results of the audit. An independent auditor must be neutral and cannot be seen to be siding with any party in order to avoid conflicts of interest that may occur (Rahmina & Agoes, 2014). The more independent an auditor is in performing his duties, the higher the quality of the audit. Based on the explanation above, the following hypothesis will be tested:

H1: Independence has an effect on audit quality.

Experience is a skill acquired by a person after working for a long period of time. Audit experience relates to the length of time an auditor has worked in the same profession as well as the number of audits they have completed in that time (Suyono, 2012). Augustine et al. (2014) states that repeated work of an auditor over a long period of time would improve the quality of audit. The more work experience possessed by an auditor, the easier it will be for them to detect, understand, and analyse at the cause of any errors found in an audit, thus resulting in an improved audit quality. Based on the explanation above, the following hypothesis will be tested:

H2: Work Experience has an effect on audit quality.

Competence of auditors relates to an auditor's ability to apply their knowledge and experience in conducting the audit so as to perform the audit carefully, accurately, and objectively (Carolita & Rahardjo, 2012). In other words, competence means a person who has the correct knowledge and attitudes of an auditor, and someone who behaves ethically in their job (Asmara, 2016). The higher the competency of an auditor, the better the audit quality. Based on the explanation above, the following hypothesis will be tested:

H3: Competence has an effect on audit quality.

Accountability is one's obligations to account for their performance on the authority entrusted to him in order to achieve the goals that have been set (Wiratama & Ketut, 2015). According to Augustine et al. (2014), accountability makes an auditor answerable to shareholders and third parties, so that the auditor feels obligated to carry out a thorough audit. A person with a high degree of accountability will have a higher sense of
responsibility to do the job in the most timely and accountable manner. Based on the explanation above, the following hypothesis will be tested:

H4: Accountability has an effect on audit quality.

Audit tenure is the duration of the auditor in conducting an audit of a company (Rahmina & Agoes, 2014). Short audit tenure results in the limited acquisition of information, data, and evidence. If an audit contains incorrect data or data that is deliberately omitted by the manager, it will necessarily be more difficult to find. On the other hand, a long audit tenure can assist auditors to develop a greater awareness of the condition of the company which facilitates the inspection process and makes it easier to detect and report errors that occur in the audit report (Nugrahanti & Darsono, 2014). However, a long tenure can also lead to the development of an emotional relationship between the auditor and the client, which can potentially reduce the independence of auditors and hence, reduce the audit quality (Kurniasih & Rohman, 2014). Based on the explanation above, the following hypothesis will be tested:

H5: Audit tenure has an effect on audit quality.

According to Al-Khaddash et al. (2013), audit fees are all expenses incurred by the company to the external auditors of audit and non-audit services provided by the auditor. This may include, for example, management advisors and consultants. The amount of an audit fee may vary depending on the risk of the task, the complexity of the services needed, the level of expertise required, the size of the audited company, and other professional considerations (Yuniarti, 2011). Members of public accounting firms are not allowed to accept clients with audit fees that could damage the image of the audit profession itself (Rahmina & Agoes, 2014). Based on the explanation above, the following hypothesis will be tested:

H6: Audit fees have an effect on audit quality.

2. Method

The subject of this study is an auditor who works in a Public Accounting Firm (KAP) in Jakarta with at least one year of experience. The sampling method used in this study is convenience sampling. The data used in this research are primary data. Data is obtained directly from the object of the research through the distribution of questionnaires. 224 questionnaires were distributed in this study to 25 public accounting firms in Jakarta. 195 questionnaires were returned and 31 questionnaires could be used. The total number of questionnaires used in this study was therefore 164. This research used a multiple regression to test the hypothesis.

Audit quality is the probability that an auditor will discover and report possible violations of his client’s accounting system (De Angelo, 1981). 10-point statements were used for measuring audit quality, 8-point statements were used to measure independence, 6 point statements were used to measure audit tenure, and 6-point statements were used to measure audit fees. The questionnaire statements were obtained from the research of Rahmina and Agoes (2014). 8-point statements were used to take measurements of work experience, 10 point statements were used to measure competence, and 10 point statements were used to measure accountability. These questionnaire statements were obtained from the research of Furiady and Kurnia (2015). The research model is shown below.
3. Results

The results of the statistical test can be seen in descriptive statistics and the hypothesis results are shown in table 1 and table 2 below:

<table>
<thead>
<tr>
<th>Variable</th>
<th>N</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit Quality</td>
<td>164</td>
<td>30.00</td>
<td>50.00</td>
<td>41.1159</td>
<td>4.12147</td>
</tr>
<tr>
<td>Independence</td>
<td>164</td>
<td>20.00</td>
<td>40.00</td>
<td>32.4451</td>
<td>3.97732</td>
</tr>
<tr>
<td>Work Experience</td>
<td>164</td>
<td>22.00</td>
<td>40.00</td>
<td>33.8598</td>
<td>3.80488</td>
</tr>
<tr>
<td>Competence</td>
<td>164</td>
<td>30.00</td>
<td>50.00</td>
<td>42.5793</td>
<td>4.09396</td>
</tr>
<tr>
<td>Accountability</td>
<td>164</td>
<td>26.00</td>
<td>50.00</td>
<td>42.2317</td>
<td>4.65444</td>
</tr>
<tr>
<td>Audit tenure</td>
<td>164</td>
<td>9.00</td>
<td>25.00</td>
<td>17.8902</td>
<td>2.85221</td>
</tr>
<tr>
<td>Audit fee</td>
<td>164</td>
<td>6.00</td>
<td>30.00</td>
<td>18.8598</td>
<td>4.58042</td>
</tr>
</tbody>
</table>

Table 2. Hypothesis Result.

<table>
<thead>
<tr>
<th>Variable</th>
<th>B</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Constant)</td>
<td>9.108</td>
<td>0.001</td>
</tr>
<tr>
<td>Independence</td>
<td>0.469</td>
<td>0.000</td>
</tr>
<tr>
<td>Work Experience</td>
<td>0.005</td>
<td>0.955</td>
</tr>
<tr>
<td>Competence</td>
<td>0.096</td>
<td>0.298</td>
</tr>
<tr>
<td>Accountability</td>
<td>0.265</td>
<td>0.001</td>
</tr>
<tr>
<td>Audit Tenure</td>
<td>0.186</td>
<td>0.035</td>
</tr>
<tr>
<td>Audit Fee</td>
<td>-0.104</td>
<td>0.054</td>
</tr>
</tbody>
</table>

Table 2 shows that independence, accountability, and audit tenure all have an effect on audit quality. The greater the independence of the auditor, the better the audit quality will be. Independent auditors will be neutral and are less likely to align with any party to reduce potential conflicts of interest. Longer audit tenures increase the ability of the auditor to better understand the client's business and obtain more detailed evidence required to improve audit quality. The higher the accountability of the auditor, the better the audit quality. Accountability of auditors increases the likelihood that the auditor will finish the job properly and timely and will carefully examine their work.
4. Discussion

The purpose of this research is to obtain empirical evidence about the factors which affect audit quality of auditors working in Public Accounting Firms in DKI Jakarta. The results of this research show that independence, accountability, and audit tenure have positive effects on audit quality. However, work experience, competency, and audit fees have no effect on audit quality. This indicates that to improve audit quality, Public Accounting Firms should pay attention to the independence and accountability of its auditors. Audit tenure also affects the auditor's ability to understand the client's company. High-quality external auditing is an important component for building public confidence of good capital markets. Companies with a reputation for credible financial reporting are always search for a high quality audit service because it increases the public’s trust in the company.

The research has several limitations. The research object used in the research includes several Public Accounting Firm (KAP) located in the DKI Jakarta area, and uses only 6 independent variables. Recommendation for further research includes expanding the study population and concentrating on more than one region, such as all auditors in Indonesia. Future research may also consider comparing conditions in different countries or add other variables that the ones used in this research model, such as number the of clients, number of tasks, client financial health, third party presence in review of audit reports, and level of audit planning.

References


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