



An Empirical Study of Auditor Independence, Competence and Audit Tenure on Audit Quality - Evidence from North Jakarta, Indonesia

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Abstract

Audit quality is very important to ensure that financial statements can be used as a basis for decision-making and can be trusted by the public. The academics generally agree that quality audit should be carried out by a competent and independent auditors. Many factors can affect the audit quality. Previous studies on found different results, so it is necessary to research to verify the theory of audit quality. The purpose of this study to find empirical evidence on the factors that affect the audit quality in North Jakarta-Indonesia. The Data were analyzed using explanatory survey. The populations in this study are 36 public accounting firms in the north Jakarta. From 105 sent questionnaire, there are only 69 respondents send their answer back and fulfill the requirements to be processed in final analysis. Meanwhile, to answer the hypothesis raised in this study, multiple regression analysis was used, after testing the classical assumption of normality, multicollinearity, and heteroscedasticity. Based on this research we concluded that, the variable of competence have no effect on audit quality, but independence and audit tenure, have a significant impact on audit quality.

Keywords: competence, independence, audit tenure, audit quality

INTRODUCTION

The number of events related to the financial scandal, have made the profession of auditors are at stake. From the case of Enron, PT. Great River International, Tbk and PT Telkom, Tbk in Indonesia have made people questioned about the credibility of the public accounting profession. Public accounting profession basically a profession which is highly dependent on public confidence. Great trust of the users of audited financial statements and other services, it should be considered by the public accountant. In other words, they have to pay attention on their quality in audit.

De Angelo (1981) states that audit quality is the probability that the auditor will find and report on the client's accounting systems. While the probability of finding violations depends on the auditor's technical capability, and depending on the probability of reporting violations of auditor independence (Deis and Giroux, 1992). Meanwhile Christiawan (2003) states that audit quality is determined by two things: the competence and independence. In performing the audit assignment, the auditor must be independent in carrying out the audit program, the independence of the verification and independence in reporting (Mautz and Sharaf, 1993). Arens et al



(2003) also suggested that auditors should be independent in terms of mental attitude and thinking (independence in fact / mind) and appearance (independence in appearance). In fact, auditors often find it difficult to maintain an independent mental attitude. Circumstances that often interfere with the independent auditor's mental attitude is as follows 1) As an independently conducted the audit, the auditors are paid by the client for his services 2) As a seller of services auditors often have a tendency to satisfy the desires of their clients 3) Maintaining an independent mental attitude can often cause loss of clients (Mulyadi, 2002).

Trotter (1986) in Murtanto (1999) defines that a competent person is a person with the skills to do the job easy, fast, intuitive and very rarely or never make mistakes. In line with the opinion of Trotter, Bedard (1986) in Sri Lastanti (2005) also defines competence as someone who has the knowledge and procedural skills are demonstrated in extensive audit experience. Meanwhile Soekrisno Agoes (2007) argues that the attainment of expertise begins with formal education, which in turn required experience in the audit practice. In addition, internal auditors must undergo adequate technical training covering the technical aspects as well as general education.

Research related to quality audit conducted by Carcello and Nagy (2004), JR Francis (2004) in which the result indicate that auditor independence have effected on audit quality. Similarly, research conducted by Widagdo, et al (2002) show that the independence of the auditor has a significant effect on audit quality. This research supported by research by JP Percy (2007) which concluded that audit quality is affected by the independence of the auditor, without the auditor independence, audited financial statements will not be qualified. Furthermore, the results of research conducted by Duff (2004) indicate that audit quality is affected by four dimensions, one of which is the independence of the auditor. Similarly, Samelson, et al (2006) also find out that independence is one of the factors that affect the quality of the audit.

Cheng, et al (2002) research's showed that auditor competence has a significant effect on audit quality. The auditor's competence can be seen from the knowledge and attitudes and ethical behavior. Indicators used in relation to knowledge are education, expertise, skills and experience. For ethical attitudes and behavior indicators used are the attitudes and ethical behavior in the work. Kaplan and Reckers (1989) suggested that the competence of auditors greatly affect the quality of the audit. A similar sentiment was expressed by Hackenbrack et al (2000) where competence auditor effect on audit quality. Further Jensen and Payne (2003) showed the influence of auditor competence through experience of auditors on audit quality.



Bonner and Lewis (1990) suggest that knowledge of the specific tasks will help the experienced auditor performance through component selection and weighting of the evidence only when they determine the analytical risk. Furthermore Choo and Trotman (1991) provide empirical evidence that more experienced auditors will be able to determine the items that are not common (atypical) than less experienced auditors. But they don't have any difference to determined common items (typical). A similar study conducted by Tubbs (1992) showed that subjects who have more experience would find more errors and mistakes items than auditors who have less experience. This is confirmed by Lawensohn, et al (2005) research who showed that competence (experience) very influential auditors on audit quality.

Several previous studies have shown conflicting results regarding the quality of the audit and audit tenure. Gosh and Moon (2003) found that audit quality increases with the length of audit tenure. Associated with long tenure, Deis and Giroux (1992) found that the longer the audit tenure, audit quality will decrease. Al-Thuneibat et al. (2011) found that the long relationship between the auditor and the client has the potential to create a closeness between them, enough to impede auditor independence and reduces audit quality. Contrary to Al-Thuneibat et al (2011), Jackson et al. (2008) found that audit quality will increase associated with the length of the auditor-client relationship.

STATEMENT OF THE PROBLEM

Based on the background mentioned above, the authors make the formulation of the problem as follows:

1. Is competence affects audit quality?
2. Is independence affects audit quality?
3. Is audit tenure affects audit quality?
4. Are the competence and independence of the effect on audit quality?

THEORETICAL BACKGROUND

Independence

Independence according to Mulyadi (2002) is the mental attitude that is free from influence, not controlled by the other party, do not depend on others. Independence also means that there is honesty in fact and in considering the existence of an objective dispassionate consideration within the auditor to formulate and express their opinions.



In this study, researchers measured independence by asking how long the relationship with the client, the pressure from clients, auditors and peer review of the provision of non-audit services.

Pressure from Clients

In performing their duties, the auditors often have conflicts of interest with the company's management. Management usually wants their company succeed which is reflected through higher earnings. To achieve these objectives it is common to pressure the auditor (Media Akuntansi, 1997). It makes auditor in dilemma. On the one hand, if the auditor follows the client's wishes, it violates professional standards. But if the auditor does not follow the client then the client may discontinue or change the assignment of auditors in KAP.

Peer Review

Peer review is a review by a public accountant, the accounting firm adherence to the system of quality control office itself (Arens et al, 2003). The purpose of peer review is to determine and report on whether the firm under review it has developed adequate policies and procedures for the five elements of quality control, and follow the policies and procedures in practice. Review is held every 3 years, and usually performed by the accounting firm selected by the agency under review.

Non-Audit Services

Audit firms services provided not only attestation services but also non-attest services in the form of management consulting services and taxation and accounting services such as financial statement preparation services (Kusharyanti, 2003)

Competence

The competence according to De Angelo (1981) in Kusharyanti (2003) can be viewed from various perspectives. The perspectives are auditor point of view (ability), there are many factors that affect the ability of auditors, including knowledge and experience. To perform the task of auditing, auditor requires audit knowledge (general and specific) and knowledge of the field of auditing, accounting and industrial clients.

Knowledge

Knowledge is measured by how high auditor education thus auditor will have more knowledge (views) on the field that they do, so they can deeply know the various issues, in addition the auditor will be easier to follow the development (Meinhard, et al, 1987).

Experience



Audit requires high expertise and professionalism. These skills are not only influenced by formal education but many other factors, among others, is experience. According to Tubbs (1992) experienced auditor has advantages in terms of: (1.) Detects errors, (2.) Understand errors accurately, (3.) Finding the cause of the error.

Libby and Frederick (1990) found that experienced auditors have a better understanding. They are also better able to give a reasonable explanation on errors in the financial statements and to classify errors based on the audit objectives and the structure of the underlying accounting system (Libby, 1985).

Audit Tenure

In Indonesia, the problem of audit tenure or tenure with the client's auditor is regulated in the Decree of the Minister of Finance No.423/KMK.06/2002 of public accounting services. The minister's decision limiting auditor tenure exceeding 3 years for the same client, while for Public Accounting Firm (KAP) may be up to 5 years.

Audit Quality

Public accountant or an independent auditor in carrying out its duties should hold these principles profession. According Simamora (2002:47) there are eight principles that must be adhered by CPAs, 1) The responsibility of the profession, 2) The public interest 3) Integrity 4) Objectivity of 5) competencies and professional prudence 6) Privacy 7) Professional Conduct 8) Technical standards.

Auditing standard is guidance to public accountant. The users of financial statements, especially the shareholders will take a decision based on audit report. This means that auditors have an important role in the ratification of a company's financial statements. De Angelo (1981), defines audit quality as the possibility (probability) that the auditor will discover and report the violations that exist in the accounting system of the client. As for the ability to find material misstatements in the financial statements of the company depends on the competence of auditors, while the willingness to report the findings of the misstatement depends on its independence.

Research Hypothesis

H1: Competence effect on audit quality.

H2: Independence effect on audit quality.

H3: Audit tenure effect on audit quality

H4: Competence, Independence, and audit tenure influence on audit quality.

Research Method

The populations in this study are 36 public accounting firms in north Jakarta. The questionnaires were filled by 98 auditors as respondents.



Table 1 Operational of Variables

Research Variable	Dimension	Scale
Competence	Knowledge	Ordinal
	Experience	Ordinal
Independence	Pressure from client	Ordinal
	Peer Review	Ordinal
	Non audit service	Ordinal
Audit Tenure	Term of relationships.	Ordinal
Audit Quality	Professional responsibility	Ordinal
	Public Interest	Ordinal
	Integrity	Ordinal
	Objectivity	Ordinal
	Competence and professional prudence	Ordinal
	Secrecy	Ordinal
	Professional conduct	Ordinal
Technical standars	Ordinal	

DATA ANALYSIS METHOD

Validity Test

Validity test of this research using the Pearson correlation between each variable questions to the average of each construct of the question. The criteria used to determine whether or not valid was 0.30 (Anwar, 2000) with the following conditions:

- a. If the index value of the validity of a test tool > 0.30 then declared valid the test tool.
- b. If the index value of the validity of a test tool < 0.30 then the test instrument is declared invalid.

Reliability Test

Reliability test can be done with a Cronbach Alpha. According to Nunnally (1969) in Imam Ghozali (2005) an instrument said to be reliable if the Cronbach Alpha value > 0.6 .

Assumptions Classic Test

Before conducting regression testing, data first tested with classical assumptions. Classical assumptions test concerning four issues of normality, heteroskedastisitas, multicollinearity, and autocorrelation. The test needs to be done



to check the violation of the assumption. For the cross section data, according to Nachrowi and Hardius (2006) include multicollinearity, heteroskeditas and error term of Normality Test

Analysis of the data in this study using multiple regression analysis using the following equation:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_1 * X_2 * X_3 + e$$

Note:

Y= Audit Quality

X₁= Competence

X₂= Independence

X₃= Audit Tenure

X₁* X₂= Interaction between competence, independence and audit tenure variable

β_0 = *Intercept*

$\beta_1, \beta_2, \beta_3, \beta_4$ = Regression Coefficients

Fault tolerance (α) set is 5% with a significance of 95%. Hypothesis testing in this study is done using simultaneous test to determine whether there are influence jointly independent variables to the dependent variable. Partial test (t test) was used to determine the effect of each independent variable on the dependent variable. Simultaneous testing criteria to test and partial test is to look at the magnitude of the probability value (ρ value) compared with 0.05 (significance level $\alpha = 5\%$).

RESULT AND DISSCUSSION

From the test of validity is known, the value of r count for all items of questions on any variable is greater than r table, so all items of questions is valid and accurate as a measure in this study and have the value of Cronbach's Alpha greater than 0.60, so it can be concluded that questionnaire is reliable. Thus, the questionnaire has been said to be accurate and consistent to be used as a measuring tool in this study. Before the multiple regression test, previously examining the classical assumption of normality test, than multicollinearity and heterocedastisity test. In this research, note that the results are free from the element of normality, multicollinearity and heterocedastisity.

Hypothesis Testing

This study examined the effect of competence, independence and audit tenure on audit quality. Overall, the results of hypothesis testing using SPSS is presented below:



First Hypothesis

Coefficients^a

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	12,432	3,555		,619	,035
Kompetensi	,829	,143	,732	-,949	,347

a. Dependent Variable : Kualitas Audit

Based on the table above it can be seen that in fact there is no influence between competence on audit quality, as indicated by the t value for -0.949 with a significance of 0.347. In other words, the first hypothesis is rejected.

Competence can be seen in many perspectives. According to De Angelo (1981), beside the auditor point of view (used in this research), the others are Audit team competence and Competence of the Firm Perspective. The audit team is seen as a more determine factor on audit quality (Wooten, 2003). Good cooperation between team members, professionalism, persistence, skepticism, strong quality control process, experience with clients, and industry experience will make a high quality audit team. Moreover, the attention of partners and managers on assignment found to have links with audit quality. Competence of the firm perspective can be seen in how big is the public accounting firms. According to Deis and Giroux (1992), Size of The public accounting firms which is measured by the number of clients and the percentage of audit fees in effort to defend his clients for not to switch to another accounting firm. Various studies (De Angelo, 1981, Davidson and Neu, 1993, Dye, 1993, Becker et al, 1998, Lennox 1999) found a positive relationship between the firm size and the audit quality. A Large KAP produce higher quality audits because there is an incentive to maintain a reputation in the market. Additionally, a large accounting firm already has a broad network of clients and they do not depend on or afraid of losing clients (De Angelo, 1981). Besides that, a large KAP usually have more resources and they train their auditors, they pay for their professional education, and they conduct audit testing.



Second Hypothesis

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	10,769	4,572		2,355	,026
	Independensi	,945	,186	,692	5,071	,000

Dependent Variable: Kualitas Audit

Based on the table above it can be seen that in fact there is influence between independence on audit quality, as indicated by the t value for 5.071 with a significance of 0.000. The positive influence between independence against the audit quality showed that the higher the independence will further improve the audit quality.

Results from this study were consistent with the previous studies that audit quality is affected by independence of auditor, without the independence of auditors audited the financial statements won't be qualified (JP Percy, 2007)

Third Hypothesis

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	10,416	,599		,471	.000
	Audit Tenure	,729	,123	,752	1,432	.001

a. Dependent Variable : Kualitas Audit

From the results of the table above shows that the value of t count for 1,432 with 0.001 significantly less than the significant value that is used in this study is 0.05. The result means that the third hypothesis can be accepted.



Long relationship between auditors with client has the potential to make the auditor is satisfied on what they have done, perform audit procedures that are less assertive and always depends on the management statement. Instead the length of audit assignment can also increase the possibility of independence for public accountants because they will familiar with the work so it can be carried out efficiently and more resistant to client pressure (Supriyono, 1988). ;

Forth Hypothesis

Coefficients^a

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	10,416	4,599		1,664	,002
Competence	,729	,123	,752	,432	,035
Independence	,678	,890	2,564	,345	,156
Audit Tenure	,434	,237	1,775	,787	,134
Interaksi	.467	,478	2.488	2,567	,001

a. Dependent Variable : Kualitas Audit

From the results of the table above shows that the value of t count for 2.567 with 0.001 significantly less than the significant value that is used in this study is 0.05. Seeing the results of the above means that the forth hypothesis can be accepted.

There are four groups of the definition of audit quality identified by Watkins et al. (2004). First, is the definition given by DeAngelo (1981b). DeAngelo (1981b) defines audit quality as the probability value-markets that the financial statements contain material misrepresentations and auditors will find and report such material misrepresentations. Second, the audit quality definition from Lee, Liu, and Wang (1999) according to them, audit quality is the probability that the auditor will not report if the audit report with an unqualified opinion on the financial statements contain material misrepresentations. The third definition is the definition given by Titman and Trueman (1986), Beaty (1986), and Krinsky and Rotenberg (1989), and



Davidson and Neu (1993). The quality of audit measured by the accuracy of the information reported by the auditor. Finally, audit quality is determined from the audit capabilities to reduce noise and bias and improving purity (fineness) of accounting data (Wallace, 1980 at the Watkins et al., 2004).

DeAngelo (1981b) agree with the opinion that the quality of the audit should be viewed from two sides: demand or input or contact with the client and supply or output or in connection with the auditor. Watkins et al. (2004) stated about 2 important things. First, ownership of resources is not more important than the use of these resources. A great accounting firm would not be more qualified than a smaller accounting firm if its resources are not used to give an opinion independently. The academics generally agree that a quality audit should be carried out by a competent and independent auditor (eg, DeAngelo, 1981, Watkins et al., 2004). The difference between perceived competence and perceived independence as in DeAngelo (1981) versus actual competence and actual independence as the Watkins et al. (2004) suggests that both competence and independence, is the main dimension of audit quality. Differences De Angelo (1981b) by Watkins et al. (2004) is the side view. DeAngelo (1981b) view of the market, whereas Watkins et al. (2004) wanted that it should be in terms of the quality of actual competence and independence. Watkins et al. (2004) mention actual competence and independence as monitoring strength.

CONCLUSION

The aim of this study is to obtain empirical evidence about the impact of the competence, independence and audit tenure of the audit quality. Therefore, based on the results of the study concluded as follows:

1. Independence and audit tenure partially have an influence on audit quality.
2. Competence has no influence on audit quality
3. Competence, independence and audit tenure have an influence on audit quality.

SUGGESTION AND LIMITATION

For next research should concerning to expand the perspective of competence not only from the auditor point of view but from audit team competence and competence of the firm perspective. There are so many factors effect on audit quality, researcher can use others factors so the problems in audit quality can be answered.

It is important to note that this study has limitations which can be addressed in future research. The limitation relates to the sample bias that might affect the generalisation of the findings. The sample was selected only from the auditor who



works in public accounting firms at North Jakarta. There are potential differences in the levels of firms size.

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