

# AUDIT FIRM SIZE, AUDIT FEE AND AUDIT QUALITY

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*This study aims to examine the determinant factors of audit quality by proposing the hypothesis that the audit firm size (size public accounting firm) and audit fees (audit fees) have an effect on the audit quality.*

*In this study, the unit of analysis is the external auditor who has worked in (Certified Public Accountant) CPA firm, the author takes the CPA Firm in Bandung, West Java, Indonesia. This type of research is descriptive verification research, because it describes the variables and observes the correlation of these variables from the hypothesis that has been made systematically through statistical testing. The statistical test use path analysis and the examination of the hypothesis in this research using two ways: simultaneous test and individual test (partial), using  $t\_test$  and  $f\_test$ .*

*Empirical test results that the CPA firm size does not significantly affect to audit quality in public accounting firm in Bandung, whereas the amount of audits significantly affect to quality of audit and simultaneously CPA firm size and audit fees do not significantly affect to quality of audit in public accounting firm in Bandung.*

**Keywords:** audit firm size (CPA firm), audit fees, audit quality

## 1. Introduction

The development of the world business is increase rapidly bring many consequences for the related parties. The complexity of the transaction will further increase over this development. This change was influenced by the external business environment and government through changes in regulations or changes in the overall business climate. Globalization is also believed become a factor in the external business environment that brings a direct impact on business continuity and daily operational practices. To survive in these conditions, the economic actors are always required perform a continuous performance improvement.

Corporate responsibilities for all economic events or financial transactions are summarized into a financial statements report. The financial statements have been prepared on the basis of records of transactions that have occurred in the company and created by the people the company itself.

Financial statements represent the financial information relating to resources owned by the company and can serve as a basis for decision making. The financial statements contain information regarding the assets, liabilities and capital of the company. The contents of the financial statements are corporate responsibility.

In the recording of these transactions may occur an error factor caused by a lack of knowledge of the recorder or because of errors that was intentional. There are several reasons why those statements must be audited by an independent party, among other things: The difference of interest between the management companies with parties outside the company causing the need for a credible third party, financial report is likely to contain both the intentional misstatement or not, and the financial statements which have been audited and received an unqualified opinion is expected by users of financial statements can be sure that those statements can be protected from material misstatement. Arrens, Elder and Beasley (2003)

Auditors are needed to examine the fairness of the financial statements which is presented by management. To perform the examination process will be the fairness of financial statements, auditors are required to be an expert as set out in Audit standard. For the attainment of expertise, an auditor must have sufficient knowledge in the field of audit .

Accountant is one profession that is needed for the company. Compared with other countries, the accounting profession in Indonesia is alarming both in terms of number and competence. The number of registered accountants on 30 April 2009 as 46,633 people while the number of accountants who have passed the certification exam public accountant only 615 people and not all practice became public accountant. *Accountant Media (2009)*

Since some of corporate failure, audit service users doubted the integrity of Certified Public Accountants, and the public confidence in the quality of audits by public accountants is decline. Public confidence in the world of the audit service profession is increasingly decline. The Public assumes that the auditor profession is a disgraceful profession because it has been duping and lying to the public (Iman, 2007). Besides the issue of corporate failure, there are also violations of the accounting firm auditing standards. It is proved by the closing CPA Firm by the Minister of Finance.

Another phenomenon that is getting attention from the public is Justinus Aditya Sidharta Audit Firm who is indicated make mistakes in the audit the financial statements. Great River International, Tbk (Winarto, 2002). The result of audit quality from Justinus Aditya Sidharta Firm is doubted after the findings of auditors from the Indonesian Capital Market Agency's investigation found indications inflate sales accounts, accounts receivable and assets up to hundreds of billions of dollars in financial statements which resulted in Great River eventually the company cash flow difficulties and failed to pay the debt (Winarto, 2002).

In Indonesia, the government as the regulator has also issued a number of provisions which regulate in detail the various matters related to public accounting profession. Regulation of the Minister of Finance Number 17/PMK.01/2008 strictly regulate the public accounting services, both the scope of work of public accountants and public accounting firms, including the rights, obligations, and the system of sanctions against violations committed by public accountants and public accounting firms .

Small Public Accounting Firm in Indonesia is higher than big Public Accounting Firm. A large number of small firm cause a high level of competition in the acquisition of clients, this requires a small firm to pay attention to the appearance and quality of staff. To improve the appearance, quality and image of public accountants, investment should be planned and prepared, it caused the firm to leave the lower prices. (Mustafa, 2009)

This is contrary to the actual reality, increasing competition among the Public Accounting Firm trigger pressure to reduce audit fees. Lowballing Cost is one of the ways used by the Public Accounting Firm in acquiring clients by setting a lower fee at the beginning of the audit assignment (Iramustika, 2008).

## **2. Certified Public Accountant (CPA) Firm**

Indonesian Institute of Accountants defines CPA Firm is a form of organization of public accountants licensed in accordance with laws and regulations that do business on the provision of professional services in the practice of public accounting. In order to perform his profession as a public accountant in Indonesia, an accountant must pass the professional exam, called the Public Accountant Certification Exam and the graduates are entitled to a BAP designation (Certified Public Accountant). Certificates will be issued by the Indonesian Institute of Accountant, the certificate is one of the requirements to get a license to practice as a Public Accountant from the Ministry of Finance.

According to the Decree of the Minister of Finance of the Republic of Indonesia No. 017/1997 43/KMK that permit open accounting firm will be granted if it meets the following requirements: Based in Indonesia, having registered accountant, being a member of the Indonesian Institute of Accountants, public accountant certification exam conducted by the IAI, having at least three years work experience as accountant and general auditing experience of at least 3,000 hours premises a good reputation, and has held office manager or team leader in a general audit of at least one year

## 2.1 CPA Firm Size

Riyatno (2007), the size of the audit firm distinction based on the number of clients and the number of members by a audit firm. CPA firm size can be divided into large and small accounting firm. Which included a large accounting firm is a Big 5 accounting firm that is: KAP Prasetio, Utomo & Rekan, KAP Hans, Tuanakotta & Mustafa, KAP Hanadi, Sarwoko & Sandjaja, KAP Hadi Sutanto & Rekan, and KAP Siddharta Siddharta & Harsono. All other accounting firm outside the Big 5 accounting firm is categorized as a small firm. Riyanto classifies based CPA firm size: the number of clients served, number of associates / members who join, and the total revenue earned in one period.

According to Mustafa (2009) large accounting firm must have 10 members of the public accountant for 3 years from 2006 to 2008, namely: Erns & Young Purwantono Sarwoko Sanjaya, Price Waterhouse Cooper and associates Haryanto Sahari , Deloitte Touche Tohmatsu Osman Bing Satrio & associates, KPMG Siddarta Sidarta & Widjaja, RSM Aryanto Amir Jusuf & Mawar, and Grant Thornton Int Hendrawinata Gani & Hidayat.

## 3. Audit Fee

Audit fee is "the fees paid for annual audits and reviews of financial statements for the most recent fiscal year (the Securities and Exchange Commission, Final Rule). Meanwhile, according to the rules of ethics of public accountants compartment, that the audit fee is "the fee amount may vary depending on the risk assignment, the complexity of services provided, level of expertise required to perform such services, the related cost structure CPA firm and other professional considerations. In the said rules CAC members are not allowed to get clients by offering a fee that could ruin the image of the profession.

Based on the Decree of the General Chairman of Indonesian Institute of Certified Public Accountants No: Kep.024/IAPI/VII/2008 that in setting fees audit, public accountants should consider the following matters: Client needs, the duties and responsibilities according to law, independence, the level of expertise and responsibility inherent in the work performed, and the level complexity of the job, the amount of time required to effectively used by a public accountant and his staff to get the job done, and establishment of an agreed fee basis.

Meanwhile, according to the Rules of Ethics of Certified Public Accountants Compartment (2001), the amount of fees depends on the following matters: risk assignment, the complexity of services provided, level of expertise required to perform such services, and the cost structure of audit firm.

## 4. Audit Quality

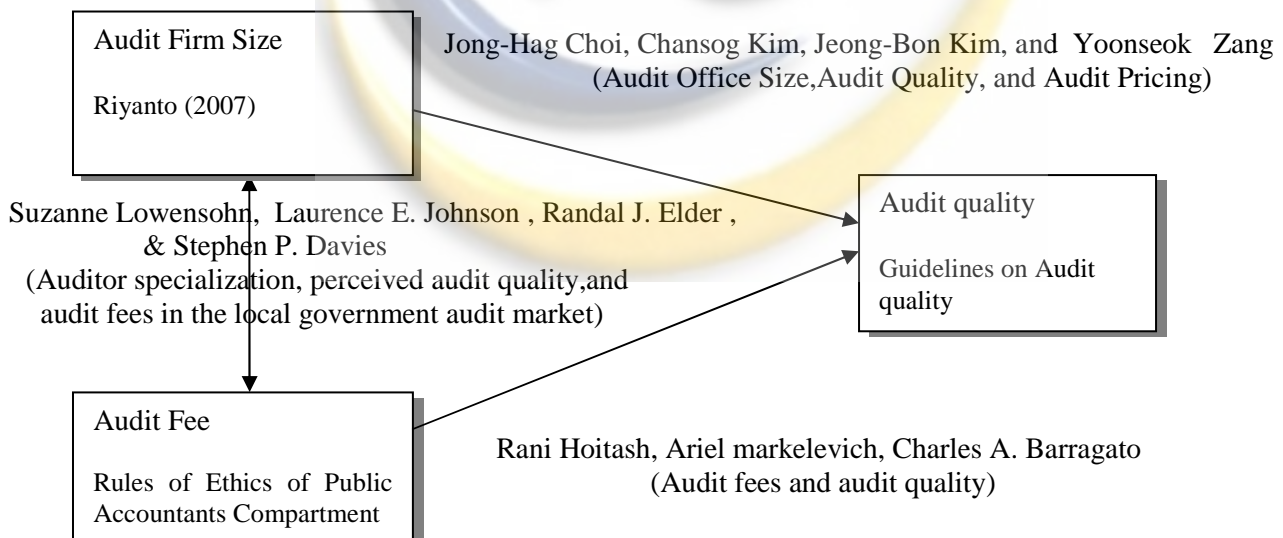
In Guidlines on audit quality, quality is: "The Bends to the which a set of inherent characteristics fulfils requirements of an audit", and characteristics of audit quality include among: **Significance** – How important is the matter that was examined in the audit? This, in turn, can be assessed in several dimensions, such as the financial size of the auditee and the effects of the performance of the auditee have on the public at large or on major

national policy issues; **Reliability** – Are the audit findings and conclusions an accurate reflection of actual conditions with respect to the matter being examined? Are all assertions in the audit report or other product fully supported by the data gathered in the audit? ; **Objectivity** – Was the audit carried out in an impartial and fair manner without favour or prejudice? The auditor should base his assessment and opinion purely on fact and on sound analysis; **Scope** – Did the audit task plan properly address all elements needed for a successful audit? Did execution of the audit satisfactorily complete all the needed elements of the task plan? ;**Timeliness** – Were the audit results delivered at an appropriate time? This may involve meeting a statutory deadline or delivering audit results when they are needed for a policy decision or when they will be most useful in correcting management weaknesses; **Clarity** – Was the audit report clear and concise in presenting the results of the audit? This typically involves being sure that the scope, findings and any recommendations can be readily understood by busy executives and parliamentarians who may not be experts in the matters that are addressed but may need to act in response to the report; **Efficiency** – Were the resources assigned to the audit reasonable in the light of the significance and complexity of the audit? ;**Effectiveness** – Did the findings, conclusions and recommendations get an appropriate response from the auditee, the government and/or parliament?

Riyatno (2007) define audit quality as something that is abstract, difficult to measure and can only be perceived by the users of audit services, so that until now there is no uniform definition of audit quality. While DeAngelo in Ebrahim (2001) defines audit quality are: "The probability combined to detect and report material errors in financial statements".

## 5. Theoretical Framework

Figure 1. Theoretical Framework



## **6. Research Methodology**

The type of research is descriptive verification research, because it describes the variables and observes the correlation of these variables from the hypothesis that has been made systematically through statistical testing (Sugiyono, 2001)

### **6.1 Population and Sample**

The population in this study is auditor in public accounting firm who registered by IAI (Indonesian Institute of Accountants) compartments public accountant in 2009 in Bandung as much as 27 Firms. The sampling technique used was purposive. Subject to be studied in this research is the auditor, and a respondent in this research are the auditor in the Firm in Bandung.

### **6.2 Data Quality Test**

#### **6.2.1 Method of Successive Interval (MSI)**

Data processing used by parametric statistical methods, the data of ordinal scale questionnaire, must be converted first into interval scale data scale. As one of the methods used is the method of successive interval (MSI).

#### **6.2.2 Validity testing**

Validity is the degree of accuracy between data to the object of research that can be reported by the researcher. To test the validity of each item is used item analysis, correlate to score each item with a total score which is the sum of each score point. Next, Product Moment correlation value calculation results is compared with the r table, if the count is greater than r table, means Product Moment correlation for each item statement was valid.

#### **6.2.3 Reliability testing**

After testing the validity, then the next step is to perform reliability testing. In this study, testing the internal consistency reliability using the instrument, where the instrument is tested only once. The data obtained were analyzed, in this case used technique of Spearman Brown split (split half).

### **6.3 Statistics Test**

In this study, the author used path analysis. Path analysis is a technique to analyze the causal relations that occurred in multiple regression when the independent variables affect the dependent variable not only directly but also indirectly. (Robert D. Retherford 1993 in Jonathan Sarwono).

### **6.4 Hypothesis Testing**

The hypothesis test in this study used two ways: simultaneously test used F\_test and individual test (partially) used t\_test. The hypothesis is formulated as below:

- Ho<sub>1</sub> : CPA firm size is not significant effect on audit quality partially in CPA firm in Bandung.
- H<sub>11</sub> : CPA firm size is significant affect audit quality partially in CPA firm in Bandung.

- Ho<sub>2</sub> : The amount of fee is not significant affect the quality of audits partially in CPA firm in Bandung.
- H<sub>12</sub> : The amount of fee is significant affect the quality of audits partially in CPA firm in Bandung.
- Ho<sub>3</sub> : CPA firm size (X<sub>1</sub>) and the amount of fee (X<sub>2</sub>) do not significant affect the quality of audits simultaneously in CPA firm in Bandung.
- H<sub>13</sub> : CPA firm size (X<sub>1</sub>) and the amount of fee (X<sub>2</sub>) significant affect the quality of audits simultaneously in CPA firm in Bandung.

## 7. Data Analysis

The number of questionnaires that had spread as much as 65 66 copies on 13 CPA firm in Bandung. The amount collected after completed by the respondents was 42 copies. After the examination, filling and full questionnaire can be used in data processing of research is as much as 37 copies. Percentage rate that answered the questionnaire amounted to 64.62%.

### 7.1 Validity Test Results

For the number of respondents 37 people with 5% significance level, then ( $r_{table}$ ) is 0.325. The validity of data for each instrument on each variable can be seen in the table below :

**Table 1. Firm Size Validity testing (X<sub>1</sub>)**

Statement Item	( $r_{calculated}$ )	( $r_{table}$ )	Note
1	0.529	0.325	Valid
2	0.335	0.325	Valid
3	0.533	0.325	Valid
4	0.515	0.325	Valid

Source:SPSS Data Processed

**Table 2. Audit Fee Validity Testing (X<sub>2</sub>)**

Item Pernyataan	( $r_{calculated}$ )	( $r_{table}$ )	Note
5	0.738	0.325	Valid
6	0.648	0.325	Valid
7	0.701	0.325	Valid
8	0.788	0.325	Valid

Source:SPSS Data Processed

**Table 3. Audit Quality Validity Testing (Y)**

Item Pernyataan	( $r_{calculated}$ )	( $r_{table}$ )	Note
9	0.708	0.325	Valid
10	0.586	0.325	Valid
11	0.673	0.325	Valid
12	0.665	0.325	Valid
13	0.594	0.325	Valid
14	0.690	0.325	Valid
15	0.619	0.325	Valid
16	0.565	0.325	Valid

Item Pernyataan	( $r_{\text{calculated}}$ )	( $r_{\text{table}}$ )	Note
17	0.626	0.325	Valid
18	0.653	0.325	Valid
19	0.749	0.325	Valid
20	0.742	0.325	Valid
21	0.742	0.325	Valid
22	0.792	0.325	Valid
23	0.628	0.325	Valid
24	0.503	0.325	Valid
25	0.806	0.325	Valid
26	0.708	0.325	Valid

Source:SPSS Data Processed

## 7.2 Reliability Test Results

After testing the validity, next step is to perform reliability testing. Reliable instrument means the instrument when used several times to measure the same object, would produce the same data. Reliability testing was conducted using SPSS 13.0 for Windows software.

**Table 4. Reliability Test Result**

Variabel	$R_{\text{calculated}}$	$r_{\text{table}}$	Note
Audit Fee( $X_1$ )	0.688	0.325	Reliable
CPA Firm Size ( $X_2$ )	0.868	0.325	Reliable
Audit qualityualitas Audit (Y)	0.939	0.325	Reliable

Source:SPSS Data Processed

Based on reliability testing calculated,  $r_{\text{calculated}}$  is greater than critical  $r_{\text{table}}$ , it show that all variables have good reliability, so that each item questions in all these instruments can be further analyzed.

## 7.3 Statistics Test (Path Analysis)

To investigate the effect of firm size, fees and audit quality variables, used path analysis. The results can be seen in the following table.

**Table 5. Correlation**

		Y	X_1	X_2
Pearson Correlation	Y	1.000	.043	.295
	X_1	.043	1.000	.167
	X_2	.295	.167	1.000
Sig. (1-tailed)	Y	.	.400	.038
	X_1	.400	.	.161
	X_2	.038	.161	.
N	Y	37	37	37
	X_1	37	37	37
	X_2	37	37	37

Source:SPSS Data Processed

**Table 6. Coefficients**

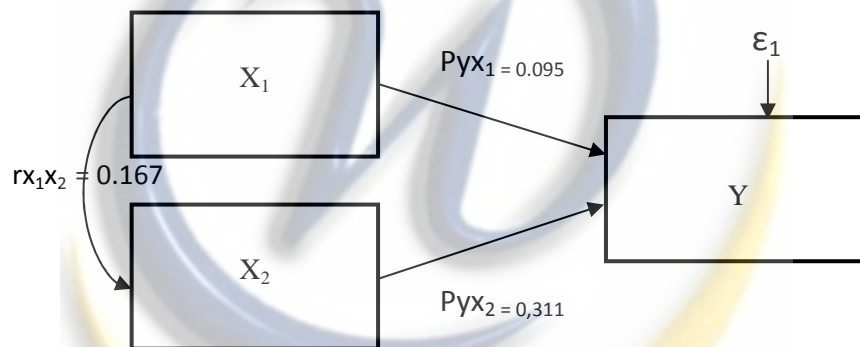
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95% Confidence Interval for B	
		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	3.317	1.103		3.007	.005	1.075	5.558
	X_1	.100	.174	.095	.574	.569	-.254	.455
	X_2	.274	.146	.311	1.878	.069	-.022	.570

a Dependent Variable: Y

Source: SPSS Data Processed 13.0

Path diagrams and structural equations based on the results of data processing, by including the estimated coefficient of the data processing is shown below :

**Figure 2. Diagram of the path analysis results**



Structural equation:

$$Y = 0.095 X_1 + 0.311 X_2 + \varepsilon$$

From the model equation above can be described as follows:

1) Influence of variable size proportionally CPA firm

- The direct effect =  $P_{yX_1} \times P_{yX_1}$

$$(0.095) \times (0.095) = 0.009$$

- Influence through correlative relationship  $X_2 = P_{yX_1} \times r_{X_1X_2} \times P_{yX_2}$

$$(0.095) \times (0.167) \times (0.311) = 0.0049$$

- Total influence =  $0.009 + 0.0049 = 0.0139$

$X_1$  variables that directly determine the changes of Y is 0.9%, while that through its relationship with the variable  $X_2$  is 0.49%, thereby totally  $X_1$  determine Y changes by 1.39%.

2) Effect of proportional variable fee scale

- The direct influence =  $P_{yX_2} \times P_{yX_2}$

$$(0.311) \times (0.311) = 0.0967$$

- Influence through correlative relationship  $X_2 = P_{yX_2} X_{rX_1X_2} P_{yX_1}$   
 $(0.311) \times (0.167) \times (0.095) = 0.0049$

- Total Influence =  $0.0967 + 0.0049 = 0.1016$

$X_2$  variables that directly determine the changes of Y is 9.67% while that through its relationship with variables  $X_1$  is 0.49%, thereby totally  $X_1$  determine Y changes by 10.16%.

3) Effect of combination of  $X_1$  and  $X_2$  to Y is:

$0.0139 + 0.1016 = 0.1155$

$X_1$  and  $X_2$  together Influence Y variable at 11.55%. The 88.45% influenced by factors beyond those variables such as audit tenure, auditor independence, and dysfunctional behavior.

### 7.4 Hypothesis Test partially (t\_test)

Test the effect of each variable firm size ( $X_1$ ) and audit fees ( $X_2$ ) on audit quality (Y) in CPA Firm in Bandung. Form the hypothesis is as follows:

- $H_{01}$ : CPA firm size is not significant partial effect on audit quality.  
 $H_{11}$ : The size CPA firm is partially significant effect on audit quality.
- $H_{02}$ : The amount of fee is partially not significantly affect the quality of audits.  
 $H_{12}$ : The amount of fee is partially significant effect on audit quality.

**Table 7. Partially Test**

Model		Unstandardized Coefficients		Standardize d Coefficients	t	Sig.	95% Confidence Interval for B	
		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	3.317	1.103		3.007	.005	1.075	5.558
	X_1	.100	.174	.095	.574	.569	-.254	.455
	X_2	.274	.146	.311	1.878	.069	-.022	.570

Source : Calculated result

### Conclusion for Partial Test

Variable	$t_{\text{calculated}}$	$t_{\text{table}}$	Conclusion
$X_1$	0.574	1.684	not Significant
$X_2$	1.878	1.684	Significant

Source : calculated result

Based on calculations in the table are 0,574 and 1,878. While  $t_{\text{table}}$  is the value of distribution at significance level ( $\alpha$ ) of 5% with degrees of freedom 37 is 1.684. If the  $t_{\text{calculated}}$  is greater than  $t_{\text{table}}$  value, the hypothesis is significant, meaning that the effects that occur can be generalized to the entire population of the auditor at CPA firm in Bandung.

Conversely, if the  $t_{\text{calculated}}$  value is smaller than the  $t_{\text{table}}$ , the hypothesis is not significant, meaning that the effect occurs can not be generalized to the entire population of the auditors on the accounting firm in Bandung. So it can be concluded that partially, CPA Firm Size does not significantly affect the Audit Quality in Bandung, while Fee significantly affect the quality of audits on CPA Firm in Bandung.

#### 7.4 Hypothesis Test Simultaneously ( $t_{\text{test}}$ )

Tested the influence of CPA firm size ( $X_1$ ) and Audit fee ( $X_2$ ) on audit quality (Y) simultaneously in CPA Firm in Bandung. The hypothesis is as follows:

- $H_0$ : CPA firm size ( $X_1$ ) and the audit fee ( $X_2$ ) does not significantly affect the quality of audits in CPA firm in Bandung.
- $H_1$ : CPA firm size ( $X_1$ ) and Audit fee ( $X_2$ ) are significantly affect the quality of audits on CPA Firm in Bandung.

To determine influence the size CPA firm ( $X_1$ ) and the audit fee ( $X_2$ ) on audit quality (Y) simultaneously, perform with the  $F_{\text{test}}$  with two-party testing in the 5% significance level (0.05). The results are as follows:

**Table 8. Simultaneous Test ANOVA(b)**

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	1.232	2	.616	1.798	.181(a)
	Residual	11.651	34	.343		
	Total	12.883	36			

a Predictors: (Constant), X\_2, X\_1

b Dependent Variable: Y

#### Simultaneous Test Conclusion

$F_{\text{Calculated Value}}$	$F_{\text{Table value}}$	Conclusion
1.798	2.88	Not Signifikan

Based on calculations derived SPSS calculation  $F_{\text{calculated}}$  value of 1.798, the rejection criteria  $H_0$  if calculation  $F_{\text{table}}$  value is greater than the  $F_{\text{calculated}}$  value, by taking the significance level of 5% then the distribution table,  $F_{\text{table}} = 2.88$ . The  $F_{\text{calculated}}$  value result is smaller than the  $F_{\text{table}}$ , so we can conclude that  $H_0$  is accepted, or in other words, the firm size ( $X_1$ ) and the amount of Audit fee ( $X_2$ ) does not significantly affect the audit quality (Y) simultaneously on CPA firm in Bandung.

## 8. Conclusion

The result of this research by testing hypothesis that CPA firm size does not significantly affect the Audit quality in CPA firm in Bandung. Audit quality are generated due to the number of audit clients who worked in a year and the number of staff in one year, and audit fees significantly affect the quality of audits. Higher fees will increase audit quality, improved audit quality is due to audit fees earned in one year and the estimated operational costs needed to implement the audit process. But Simultaneously, CPA firm size and amount of audit fee simultaneously did not significantly affect the audit quality in CPA firm in Bandung.

## 9. Suggestions

To improve the audit quality, public accounting firm should increase the amount of audit fees earned in one year, making the estimated operational costs needed to implement the audit process, increase the number of audit clients in one year and have an adequate number of staff in one year, and for further researchers should add more references and further expand the object of research. In addition to research in Bandung are advised to use other variables outside CPA firm size variables and the amount of fees, including audit tenure, premature sign-off, individual culture, and dysfunctional behavior.

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