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The Effect of Audit Quality and Corporate Governance on Auditor Performance: An Empirical Study on Public Accounting Firms in Indonesia

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Abstract:

The purpose of this study was to test the effect of audit quality and corporate governance on auditor performance. The population of this study was 600 auditors in public accounting firms in Malang and Surabaya, East Java, Indonesia. Data were collected from 150 auditors consisted of partners, managers, supervisors, senior auditors, and junior auditors in the public accounting firms through a questionnaire survey. Structural Equation Modelling was employed to test the relationships. The result of this study showed that audit quality and corporate governance had a significant effect on auditor performance. This study was limited only to the implementation of audit quality and corporate governance on auditor performance in Public Accounting Firms in East Java, Indonesia. The study was expected to reveal audit quality and corporate governance in Public Accounting Firms in East Java to improve auditor performance.

Keywords: *Audit quality, corporate governance, auditor performance, SEM*

1. Introduction

Auditor performance represents the results achieved by an auditor of a public accounting firm when the auditor performance audit on a client's financial statement; the result may be influenced by the quality and quantity of the audit (Mangkunegara, 2015). In auditing, an auditor must give the best reliable service possible. Auditor quality covers independence, competency, and professional judgment completed with good supervision, internal control system, audit evidence, as well as audit processes in line with the financial accounting standard of Indonesia applied in such a consistent manner along with full disclosure of fair financial statements.

De Angelo (1981) defines audit quality by a two-dimensional definition: first, detecting misstatements and errors in the financial statement, and second, reporting these material misstatements and errors. Lee, Liu, and Wang (1999) define audit quality as a probability that an auditor will not make any audit reports under an unqualified opinion for financial statements containing errors. Audit quality refers to the probability of an auditor to find and report an error or bias in an accounting system of a client. Audit quality covers (1) *input orientation*, consisting of assignment of personnel by public accounting firms for contract agreement, consultation, supervision, appointment, professional development, promotion, and inspection; (2) *process orientation*, consisting of independency, compliance with audit standards, audit control, and competence; (3) *output orientation*, consisting of auditor performance, accepted and continuous cooperation with clients; and (3) *due professional care* (Tandiontong, 2015).

The core principles of good governance at public accounting firms include fairness, transparency, accountability, responsibility, and independence. (1) *Fairness* means that public accountants must be independent and fair in assessing financial statements of clients for the interest of the clients and the accountability of the accountants themselves. (2) *Transparency* means that public accountants must give clear and thorough information related to the financial statements of the clients. (3) *Accountability* means explaining actors and accountability throughout the audit process, being accountable for the work done, and doing work completely. (4) *Responsibility* refers to compliance with accounting standards and a professional work ethic. (5) *Independence* means a public accountant must be objective in doing the work.

Examples of the implementation of audit quality and good corporate governance in Indonesia can be seen in companies like Lippo Bank, Muzatek, KAI, KPMG Sidharta, Malinda Dee City Bank, and KAP Anderson. The international examples would be Enron and Worldcom. Therefore, external audits must consider audit quality under the professional standards of public accountants and good corporate governance under existing theories to increase auditor performance.

Previous studies mentioned several measurements related to audit quality, including audit professionalism, audit process, and audit results (Neely, 2016). Meanwhile, good corporate governance includes aspects like fairness, transparency, accountability, responsibility, and independence (Nu Nu, 2016). Auditor performance is measured using validity, reliability, quantity, and timeliness (Karlbers dan Forgatty 1995).

In this present study, audit quality consisted of professionalism (experience, expertise, technical training, and competency), audit process (response to clients' needs, independency, commitment, planning and supervision, understanding of internal control system and collecting audit evidence), and audit result (fairness of financial statements and auditor opinion). Good corporate governance consisted of fairness, transparency, accountability, and responsibility. Meanwhile, auditor performance was measured using the criteria of validity (education), reliability (expertise and experience, participation, reading of journals, incentive, and good work), quantity (quantity of work, timeliness, accuracy, and validity), quality (quality of work, number of clients), timeliness (auditor performance concerning assigned tasks or ability to meet the plans). This study was applied in public accounting firms in East Java, Indonesia.

2. Theoretical Review

Performance is a result of output from a process (Nurlaila, 2010). According to approach behavior in management, performance is quantity or quality of something produced or service given by someone (Luthans, 2005). Kalbers dan Forgarty (1995) define auditor performance as evaluation done by a boss, a co-worker, or direct subordinate or even by the person doing the work. The study of Trisnaningsih (2005) show that auditor independence, organization commitment, good governance, and organizational culture have a significant influence on auditor performance, while good governance does not have a significant influence on auditor performance in public accounting firms. Yuskar and Devisia (2009) show that auditor independence, organization commitment, auditor integrity, and organizational culture have a significant influence on auditor performance, while good governance does not have a significant influence on auditor performance.

Neely (2017) examined auditor quality by proposing 28 indicators of audit quality consisting of three (3) dimensions: audit professionals, audit processes, and audit results. (1) *Audit professionals* cover (a) availability including (i) staffing leverage, (ii) partner workload, (iii) manager and staff workload, (iv) technical accounting and auditing resources, and (v) persons with specialized skill and knowledge; (b) competence including (i) experience of audit personnel, (ii) industry expertise of audit personnel, (iii) turnover of audit personnel, (iv) amount of audit work centralized at service centers, and (v) training hours per audit professional; and (c) focus including (i) audit hours and risk areas and (ii) allocation of audit hours to phases of the audit. (2) *Audit processes* cover (a) tone at the top of leadership including results of an independent survey of firm personnel; (b) incentives including (i) quality ratings and (ii) compensation audit fees, effort, and client risk; (c) independence including compliance with independence requirements; (d) infrastructure including investment in infrastructure supporting quality auditing; and (e) monitoring and remediation including (i) audit firms' internal quality review results, (ii) inspection results, and (iii) technical competency testing. (3) *Audit results* consist of (a) financial statements including (i) frequency and impact of financial statement, (ii) restatements for errors, (iii) fraud and other financial reporting misconduct, and (iv) inferring audit quality from measures of financial reporting quality; (b) internal control including timely reporting of internal control weaknesses; (c) going concerned including timely reporting of going concern issues; (d) communications between auditors and audit committee including results of independent surveys of audit committee members; and (e) enforcement and litigation including (i) trends and enforcement proceedings and (ii) trends in private litigation.

To sum up, audit quality is achieved by auditors gathering sufficient appropriate audit evidence to express an opinion on whether the financial statements are prepared, in all material respects, under the applicable financial reporting framework. This is determined under several key elements of experience, technical expertise, and training, response to the needs of clients, competence, independence, organizational committees, internal control system compliance, preparation of audit reports and recommendations, ethical standards, auditor reputation, peer review, and interaction. Audit results show that audit professionals and processes have a significant effect on auditor performance. However, Praptitorini, and Januarti (2010) show that audit quality does not have a significant effect on auditor performance. Susiana and Herawati (2007) show that independence and corporate governance have a significant influence on auditor performance, while auditor quality does not have a significant effect on auditor performance.

Abidin (2018) confirms a significant effect of corporate governance on audit quality and auditor performance in Malaysian stock exchange. Outa (2014) finds that corporate governance can improve the financial performance of 520 companies in Kenya. Trisnaningsih (2005) shows that good governance does not have a significant effect on auditor performance. Yuskar and Devisia (2009) reveal that good governance and work ethos does not have a significant effect on auditor performance. Htay (2006) confirms that corporate governance affects the performance of sharia and non-sharia companies in Malaysia.

2.1. Theoretical Framework and Hypotheses

This study examined the effect of audit quality and good corporate governance on auditor performance in the context of public accounting firms. The research subjects were partners/managers/supervisors at public accounting firms. Audit quality is reflected in the existence of auditing standards (competence, skills, independence, expertise, and technical training), well-planned audit processes, supervisors understanding internal control systems in conducting an audit (inspections, observations, confirmations of requests for information from clients), and audit results confirming that financial reports of clients have been prepared under the financial accounting standards applied consistently and in full disclosure. Good corporate governance from public accounting firms in Indonesia is reflected by good management of the community accounting office in all related matters ranging from planning of work to reporting results of examinations. Trisnaningsih (2007) confirms that good corporate governance does not significantly influence auditor performance. Yuskar and Devisia (2009) find that good corporate governance has no significant effect on auditor performance. Figure 1 shows the relationship between the research framework:

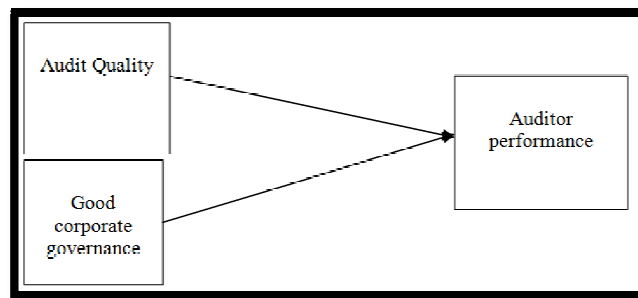


Figure 1: The Research Model

2.2.1. Audit Quality on Auditor Performance

Violations of audit quality and professional standards of public accountants in Indonesia from 2010 to the present have been found in cases like Muzatek, BRI, KPMG Sidharta, KAP Anderson, Malinda Dee City Bank, Bank Lippo, and Wordcom. Violations of the code of ethics lead to the need for reexamining the compliance of public accounting firms with auditing standards and guidelines and their effects on the performance of auditors in Indonesia. Neely (2017) examined auditor quality by proposing 28 indicators of audit quality consisting of three (3) dimensions: audit professionals, audit processes, and audit results. Neely's research has confirmed the importance of identifying audit quality to support the objectives of a public accounting firm in improving auditor performance and the reputation of the public accounting firm itself. Yuskar and Devisia (2009) examine the effect of audit quality on auditor performance and conclude that audit quality has a significant effect on auditor performance. Thus, the hypothesis is as follows:

H1: Audit quality positively affects auditor performance.

2.2.2. Good Corporate Governance on Auditor Performance

A comparative study by Ibrahim, Fatima, and Htay (2006) examined the effect of corporate governance and performance between sharia and non-sharia companies in Malaysia; they confirmed that corporate governance had a significant effect on auditor performance. Trisnarningsih (2005) investigated the effect of good corporate governance on the performance of auditors in 150 public accounting firms in East Java through organizational commitment; she found that good corporate governance did not significantly influence auditor performance. Salin (2008) investigated the relationship between good corporate governance and auditor performance on the Malaysia Stock Exchange and found that good corporate governance had a significant effect on auditor performance through organizational commitment. Since the crisis in Hongkong, Singapore, and Malaysia, Sawicki (2009) found that corporate governance, such as the existence of transparency, fairness, and accountability for financial data, helped to improve auditor quality and auditor performance. Mahoney *et al.* (1963) show a positive relationship between good governance and auditor performance.

Organizational performance is an organizational capability for efficiency and utilization purposes by using resources (Daft, 2000). Organizational performance can be measured using non-financial and financial categories such as link customer, quality, quantity, and timeliness (Kaplan and Norton, 2001). There is a relationship between good corporate governance and performance based on the study of Denison (1984), researching 34 companies in America for 5 years, and Kotter and Heskett (1992), examining the relationship between corporate governance and organizational performance involving 200 companies.

Auditors from public accounting firms must provide fair and reasonable audit results to any of the financial reports of their clients for the interest of the clients and the auditor themselves. Transparency must be managed for all matters related to the examination in the field and the opinions on the fairness of financial reports and other materials. Accountability and responsibility require auditors to record and report the audit results to clients by making reports to be submitted to the clients and then forwarded to users of audited financial reports such as government, creditors, investors, academics, and customers. Thus, the hypothesis is formulated as follows:

H2: Good corporate governance positively affects auditor performance.

3. Research Method

This study aimed to describe, explain, and analyze the effect between variables (audit quality, good corporate governance, and auditor performance). This study used a survey since it aimed at explaining symptoms and knowing causal relationships between variables. The search was quantitative with causality design—showing the effect of the independent variables (audit quality and good corporate governance) on the dependent variable (auditor performance). Samples were taken purposively from the population. The primary data was taken from public accountant offices in Java as respondents through direct interviews and questionnaires.

3.1. Population and Sample

The population in this study was 488 colleagues at 124 public accounting firms in Java. The samples were 150 auditors as active partners at the firms. Samples were chosen purposively under the following criteria:

- Public accounting firms listed on the Institute of Indonesia Chartered Accountants in 2018 and accountants having a registered account;
- Actively conducting general assignment on several companies, and
- Auditors with minimum three-year work experience.

Based on the data on the directory of the Institute of Indonesia Chartered Accountants in 2018, there were 124 registered public accounting firms in Java, consisting of 100 partnership business and 24 individual businesses. They include HJA public accounting firm, Doli BSDA public accounting firm, Supriyadi public accounting firm, Nasikin public accounting firm, MTD public accounting firm, Toufan SR public accounting firm, Achsin public accounting firm, Benny public accounting firm, Sendi Cahyadi public accounting firm, Drs. Arief HP public accounting firm, Buntaran and Lisawati public accounting firm, Maroeto public accounting firm, Thomas public accounting firm, Basri public accounting firm, Setijawati public accounting firm, Drs. Dwikora public accounting firm, Drs. Kukuh public accounting firm, Drs. Jimny public accounting firm, and Drs. Nugroho public accounting firm. Data were collected using a mail survey questionnaire. The informants for this study were partners, managers, supervisors, senior accountants, and junior accountants. Of the 175 questionnaires mailed out, 150 were filled in and returned, indicating a response rate of 85%. Documentation and interviews were done with auditors from the public accounting firms in East Java, Indonesia.

3.2. Measures

The primary data was the score of each indicator of the variable in the questionnaire distributed to the respondents. All the constructs were measured using a five-point Likert scale (1 for Strongly Disagree, 2 for Disagree, 3 for Neutral, 4 for Agree, and 5 for Strongly Agree). Measurements were adapted from existing literature. Table 1 presents the measurements of all the variables in this study.

In addition to questionnaire results, data were also collected by documentation from 24 PAFs in East Java. A Structural Equation Modelling (SEM) was employed in the data analysis. We conducted validity and reliability tests, a classic assumption test, and a Structural Equation Modelling test.

3.3. Research Variables

Independent variables in this research were audit quality and good corporate governance, and the dependent variable was auditor performance.

3.4. Conceptual Definition

3.4.1. Auditor Quality

Auditor quality, according to Neely (2017), is a measure of quality regarding the work carried out by the auditor in examining financial reports of clients starting from the preparation of the audit program to the implementation until the preparation of the audit reports.

3.4.2. Good Corporate Governance

Good governance can be measured using the instrument indicators developed by the Indonesian Institute of Corporate Governance (IICG, 2017).

3.4.3. Auditor Performance

Performance is an overview of the level of achievement of an activity or program policy in realizing the goals of the organization; performance is often used to refer to the achievement or the level of success of individuals or groups (Kalbers and Forgatty, 1995).

3.5. Operational Definition

3.5.1. Audit Quality

Audit quality is the possibility for an auditor to find error and fraud occurring in the financial statements and in the accounting information systems of their clients based on the standards and criteria applicable at the time of examination. The indicators include the quality of the auditor (competency, independence, and professional judgment), the quality of the audit (audit plans, internal control systems, and audit evidence), and the quality of the audit result (financial statements consistent with the accounting standards, full disclosure, and auditor opinion).

3.5.2. Good Corporate Governance

Good corporate governance means a public accountant firm exercising fairness, justice, accountability, responsibility, and independence in any of the work it does.

3.5.3. Auditor Performance

Auditor performance refers to the results of the audit in which the auditors have given their opinion on the financial statements according to the financial accounting standards and the auditors are compliant with the professional public accountant standards. The indicators include education, expertise and experiences, age, reading auditing and accounting publication, giving incentives, motivation for good, quality of audit working paper, the quantity of assignment, and timeliness.

3.6. Research Instruments

The summary of the research instruments is presented in Table 1.

Variable	Indicator	Item Indicator	Sources	
Audit Quality	Audit Professional	Audit experiences	Neely (2016)	
	Audit process	Expertise and technical training		
		Competency		
		Response to clients' need		
		Independency		
		Commitment		
		Planning and Supervision		
	Understanding internal control system and collect audit evidence			
	Audit result			Fairness of financial statement and audit opinions
		Ethical standards		
Good corporate governance	Fairness	Fairness	IICG, Puteh, Nu Nu (2016)	
	Transparency	Transparency		
	Accountability	Accountability		
	Responsibility	Responsibility		
Auditor Performance	Validity	Education	Kalbers and Forgatty (1995)	
	Reliability	Expertise and Experience		
		Age of PAFs		
		Participation in auditor meetings		
		Read of journal		
		Incentive giving		
		Doing good		
	Quantity	Quantity of work, timeliness, accuracy, and validity		
	Quality	Quality of work		
		Number of clients		
Timeline	Auditor performance is influenced by assignment in audit or quantity in line with the plan			

Table 1: Research Instrument: Variables, Indicators, and Sources

3.7. Data Analysis Technique

3.7.1. Validity Test

According to Masrun (in Solimun, 2002), if the correlation coefficient between the score of an indicator is greater than 0.3, then the instrument is said to be valid.

3.7.2. Reliability Test Instrument Research

The Cronbach Alpha procedure was used to answer the reliability of the instrument. According to Malhotra, an instrument is considered quite reliable when the Alpha value is greater than or equal to 0.6.

3.7.3. Assumption in SEM

3.7.3.1. Sample Measurement

According to Hair (2005), the minimum sample size that must be met in modeling is 100-200 of respondents.

3.7.3.2. Normality and Linearity

A test of normality is done by looking at the histogram image or by conducting a statistical method. A test of linearity is done by observing scatter plots at 99% confidence level and Z number with cr skewness -2.58% to 2.58% (Santoso, 2011).

3.7.3.3. Outlier

If it is tested against multivariate outliers, Mahalanobis distance at level p is smaller than 0.001. If Mahalanobis distance is greater than the chi-square value, the multivariate outlier does not occur.

4. Result and Discussion

4.1. Test Results of the Structural Equation Modelling

SEM test results showed no problem of multicollinearity and outliers; data were normally distributed. To facilitate the evaluation of the external model, the following path analysis is presented.

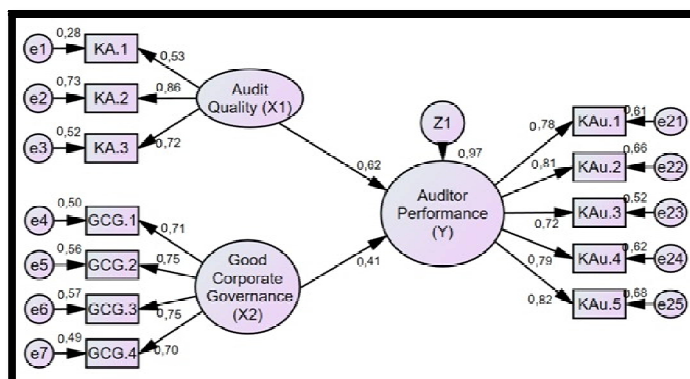


Figure 2: A Path Diagram of the Structural Equation Modelling(SEM)

The path diagram in the Structural Equation Modelling above can be converted into the following equation:

$$Y = 0.62 X_1 + 0.41 X_2 + e_1$$

The structural equation above shows the relationship between exogenous latent constructs. The auditor performance variable is dominantly influenced by audit quality (X1) where the highest influence value is 0.62. The best indicator shaping the audit quality variable is KA2 (audit process) since it has the highest loading factor of 0.856. Thus, if the firms want to increase the value of audit quality (X1), the statistical recommendation is to prioritize improvement in KA2 (audit process).

The Structural Equation Modelling analysis was done using AMOS 16for Windows (the complete results are presented in the attachment).

All the goodness of fit of all criteria is as set out in Table 2.

The Goodness of Fit Index	Cut-off Value	Results	Description
Chi-Square / CMIN	< Chi Table : Good fit > Chi Table: Poor fit	75.72	Model poor fit
P-value CMIN	> 0.050 : Good fit	0.004	Model poor fit
CMIN/DF	< 2,000 : Good Fit	1,646	Model good fit
RMSEA	< 0.080 : Good fit	0.066	Model good fit
GFI	> 0.900 : Good fit	0.924	Model good fit
AGFI	> 0.800 : Marginal fit	0.87	Model marginal fit
TLI		0.959	Model good fit
CFI		0.972	Model good fit

Table 2: The Goodness of Fit Indexes and Cut-off of SEM

Source: Primary data analyzed(2019)

The calculated chi-square value is 75.72 greater than the value of the chi-square table (75.72 > 62.830); thus, it was declared as a poor fit. CMIN/DF is1,646 and based on accuracy criteria, the model is declared as a good fit since it is smaller than 2,000. RMSEA is 0.066, which is smaller than 0.080; thus, it was declaredas a good fit. GFI is 0.924or is bigger than 0.900so the model has a good fit. AGFI is 0.87,which is bigger than 0.8 so the model has amarginal fit. TLI is 0.959, which is bigger than0.9, so themodel has agood fit. CFI is 0.972or bigger than 0.9so the modelused has a good fit.

Table 3shows the result of Structural Equation Modelling testing. The values for Chi-Square/DF, RMSEA, GFI, and TLI have met the recommended.

Variable			Direct Path Coefficient	Hypothesis Testing		Description
Exogenous	→	Endogenous		CR	p-value	
Audit Quality (X1)	→	Auditor Performance (Y)	0.616	3.478	0.000	Significant
Good Corporate Governance (X2)	→	Auditor Performance (Y)	0.41	2.549	0.011	Significant

Table 3: Estimation Results and Hypothesis Testing Results
Significant at 5%

Table 3 confirms that audit quality (X1) has a positive effect on auditor performance (Y), which means high audit quality (X1) will increase auditor performance (Y). The path coefficient is 0.616 with a t-value of 3.478. Because the t-value is bigger than the critical value ($3.478 > 1.96$), H_0 is rejected, meaning that audit quality (X1) has a significant effect on auditor performance (Y).

Good corporate governance (X2) has a positive effect on auditor performance (Y), meaning that high good corporate governance (X2) will increase auditor performance (Y); the path coefficient is 0.41 with a t-value of 2.549. Because the t-value is bigger than the critical value ($2.549 > 1.96$), H_0 is rejected, meaning that good corporate governance (X2) has a significant effect on auditor performance (Y).

4.2. The Effect of Audit Quality on Auditor Performance

Based on the results, audit quality has a significant effect on auditor performance; it is reflected in the work of auditors in auditing financial statements, which corresponds with the professional public accountant standards. Financial statements of the clients have been arranged accordingly with International Financial Reporting Standards (IFRSs) and the accounting information systems. This result supports the one presented by Neely (2016).

4.3. The Effect of Good Corporate Governance on Auditor Performance

Based on the results, good corporate governance has a significant effect on auditor performance; it is reflected in the work of auditors that applied good corporate governance (fairness, justice, accountability, responsibility, and independence). The results support the one presented by Abidin (2018) that good corporate governance will influence auditor performance and Outa (2014) that good corporate governance will improve financial performance.

5. Conclusions and Limitation

5.1. Conclusions

Audit quality has a significant effect on auditor performance; it is reflected in the work of auditors in auditing financial statements, which corresponds with the International Financial Reporting Standards (IFRSs) and based on the accounting information systems. Auditors have also been obedient to professional public accountant standards as the adoption of standards from International Standard Auditing (ISA).

Good corporate governance has a significant effect on auditor performance; it is reflected in the work of auditors that applied good corporate governance by being fair, accountable, responsible, and independent in doing their work.

The present study has proven that auditor performance can be influenced or improved by audit quality and good corporate governance. This will be such good information for public accounting firms in improving their performance. This research is expected to enrich and develop concepts related to audit quality and good corporate governance.

5.2. Limitations and Suggestions

The present study indicates that audit quality and good corporate governance can improve auditor performance. Leaders of public accounting firms are expected to organize programs that can increase employee motivation, improve employee welfare, and provide adequate work facilities.

The present study, however, only covered public accounting firms in East Java with 150 active auditors as the respondents and with three (3) variables of audit quality, good corporate governance, and auditor performance.

Further studies are encouraged to develop the research model by adding other variables, such as auditor opinion, to strengthen the research results. Larger samples may also be needed to generalize the results to a bigger population.

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