

Survey of the impact of independence and audit quality on the reputation of an accountancy agent

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ABSTRACT

This study develops a conceptual model to correlate the effect of Independence, and size of Public Accountant Office toward audit quality and its impact on the reputation of the Public Accountant Office. This is ongoing research, where the model was developed based on theory and the results of previous studies. The results of this study are expected to provide meaningful information for those who want to know more about the relationship of variables in the development of the study of accounting with respect to the independence of the public auditing, the size of Public Accountant Office, audit quality and reputation of the Public Accountant Office, so it can be used as a reference in the development of similar research in the future. In this study, the independence is elaborated into two indicators, both are integrity and Objectivity, for the size of Public Accountant Office, the researcher analyzed it into three indicators: the number of branches owned, the number of international affiliates as well as the amount owned of the audit staff owned. Furthermore, audit quality is classified into indicators, namely: skill, experience, ethical values, mindset, the reliability of the audit method, the effectiveness of the tools used and the technical support. Meanwhile, the Public Accountant Office's reputation is classified into two indicators, namely the competence of the Public Accountant Office and its excellence compared to the other public accountant Offices.

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1. Introduction

Public accounting is a profession that provides services to the general public, especially in the field of audit or financial report made by his client. The audit is primarily intended to meet the needs of users of financial information such as investors, creditors, prospective creditors and government agencies (Boyton et al., 2006).

As a profession which people give their trust to, it will require public accountants to pay attention to the result of audit quality, but the accounting scandal that occurred in major U.S. companies such as Enron, WorldCom, has damaged public trust and credibility that resulted in substantial criticism of the business (Frohnen and Clarke, 2002). The case of Enron failure is one evident that accounting ethics is required (Elias, 2006), especially the application of professional ethical standards in the form of auditor independence. For that case, auditor independence has become an important issue for the public accounting profession (Gendron et al., 2006).

Besides, Public Accountant Office to audit the accounting scandal exposed is also considered a large Public Accountant Office that has a good reputation in the financial sector, but it did not guarantee and prove that the company's financial report reflect the truly value of the company.

In Indonesia, many kinds of sanctions have been imposed by the government to Public Accountant Office. Since June 11, 2008, and June 20, 2008 the Minister of Finance has frozen public accounting license and one public accountant permit. Freezing was done because the accountant had violated auditing standards in the implementation of the audit of the consolidated financial report. License suspension of sanctions cases against public accountants, as stated earlier, it appears that there are still auditors who do not meet the audit standards that result in poor quality of the audit.

Audit quality refers to the standards and criteria relating to the implementation of quality standards (Boyton et al., 2006). Hamilton et al., (2005) stated that one of the things that can hinder the ability of public accountant to provide a high quality audit is a long period relationship between the client and the accountants that can increase the intimacy occurring

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between public accountant and the client, which finally will cause disruption of auditor independence. The independence of the public accountant is one factor that is often cited by the researchers that is considered to be crucial to the quality of the audit.

A further factor that is seen to have an influence on audit quality is the size of Public Accountant Office (Niemi, 2004; Francis and Yu, 2009; Choi et al., 2010). Firth and Tan (1998) suggested that audit quality is often associated with the size of the Public Accountant Office. Hogan (1997) explained that the big office can provide a better audit quality. On the other hand, a Public Accountant Office that has a big name is seen as an auditor that will generate audit quality levels that exceed the minimum requirements of professionalism compared to the quality of the Public Accountant Office that does not have a well-known name.

Furthermore, when related to the reputation, quality audit is one of the main factors that determine the reputation of Public Accountant Office (Baotham; 2009), in which the office needs to make efforts to improve the quality of the resulted audit, because if it is not capable to provide the high-qualified audit results, the eputation in the community will be threatened. For Public Accountant Office, reputation is a very important factor, because if the office has a good reputation many companies will have interest in using their services, for the results of the audit of the office will obtain a high level of trust from the community (Baotham, 2009). In relation to the company's reputation, MacMillan et al., (2004) states that a company may have a reputation for getting the different characteristics from the other companies, behavior or different results for each company, including the aim to gain financial success, the desires to grow to be big, strong and innovative. Meanwhile, Helm et al., (2007: 3) argues that reputation is the most relevant asset, which is difficult to obtain, but it can be easily lost if not managed properly.

Based on the description above, the author was interested to deeply explain the effect of the independence and the size of the Public Accountant Office toward audit quality and its impact on the reputation of a Public Accountant Office.

2. Materials and methods

2.1 Independence

Auditor profession in conducting verification must not be separated from an independent attitude in serving his client. In this regard, independent means being independent toward the information submitted by the client (Kinney, 1999). The independence is essentially an attitude of mind which is characterized by a person's approach to the integrity and objectivity of the professional duties

(Arens and Beasley, 2012). The Barlett (1993) defines independence as a mental attitude that is not biased in auditing financial report.

From the various opinions expressed above, it is understood that independence is an absolute attitude that must be owned and guarded by the auditor; it is the independence in terms of maintaining appropriate behavior in the assignment, as well as the independence in maintaining its image as a group that espouses the trust from society. Public accountant who perform audit activities is necessary to maintain his independence by maintaining the integrity and objectivity in carrying out professional responsibilities (Arens and Beasley, 2012).

Based on the previous description that independence can be explained in this study viewed from two indicators, they are keeping the integrity and objectivity. Here, integrity means a person's attitude acting or doing something in his conscience, being honest, viewing and forwarding the facts as what they are (Arens and Beasley, 2012). On the other hand, the objectivity is an impartial manner and being free of conflicts of interest (Messier and Douglas, 2008).

2.2 Size of public accountant office

Public Accountant Office has a legal status to conduct an audit of financial report based on state regulation. In addition, public accounting provides other services for its clients such as the special audit, tax services, other attestations, accounting services, management consulting (Arens and Beasley, 2010)

Furthermore, Arens and Beasley (2012) categorize the size used to describe a Public Accountant Office in the United States, namely:

1. The Big Four International office in which this office has branches throughout the United States and around the world, this big four office audit almost all big companies in both the United States and around the world.

2. National Office where the office is large but much smaller than the big four, this office has an affiliation with another office in another country and has international capability.

3. Big regional and local office where the office has more than 50 professional staff, some only have one office and the other Public Accountant Office has several branches in one state.

4. Local small office which has less than 25 professionals and the office have only one branch.

Public Accountant Office that has a big name is seen as a public accountant who will produce the level of audit quality that exceed the minimum requirement of professionalism compared with the quality of the Public Accountant Offices that do not have a big name.

Furthermore, when associated with the quality of the audit, Public Accountant Office is mutually connected to the quality of audits, as revealed by Lennox (1999), the size of Public Accountant Office as a quality proxy distinguish the Big four accounting office and small non-big four accounting office. The difference was based on the number of clients served by the office and the number of associates who join.

From previous studies, it can be said that the Public Accountant Office has the responsibility to provide audit services to the financial report made by the company, where the categorization of Public Accountant Office size is based on three things are used as indicators in this study, namely, first, the number of branches owned. Second, the number of international affiliates, signed with the number of Public Accountant Office cooperation with other parties in other countries. Third, the number of audit staff, the number of staff who joined the Office of Public Accountants (Arens and Beasley, 2012).

2.3 Audit Quality

Audit Quality is normally related to the ability of the auditor to identify material misstatement in the financial statements and their willingness to issue an appropriate and unbiased audit report based on the audit results (Turley and Willekens, 2008).

There are two approaches used to evaluate a decision in general, both are the outcome oriented and process oriented (Chrystelle, 2006). For process-oriented approach, Richard (2006) argues that in the context of process-oriented, quality audit can be seen from: (i) the level of auditor's compliance to standards, (ii) the level of auditor specialization in a particular industry. For a results-oriented approach, Richard (2006) measured the quality of an audit by the result of audit. Audit result can be observed is the audit reports and financial report. The size observed in the audit report is to issue going concern opinions when the company went bankrupt (Carey and Simnet, 2006).

Audit quality from the perspective of the International Auditing and Assurance Standard Board (IAASB) is indicator that will be used in this study. Conceptually, IAASB states that there are three fundamental aspects of audit quality, namely input, process and context factors. The input in audit quality has two dimensions: (1) personal attributes of public accountant with expertise and experience indicators, ethical values and mindset, (2) audit process with the indicator of the reliability of audit method, the effectiveness of the tool audit used, and the availability of technical support. Then, the output of audit quality has two dimensions: (1) public accountant report, (2) communication public accountant. Further context factor has two dimensions: (1) governance and (2) Law and regulations.

Based on previous studies, it can be concluded that the quality of public accounting audit

constitutes the ability to find and report the errors of significant misstatement in the financial report of clients. There are seven factors that determine the ability of public accounting to find and report errors (Bedard et al., 2010), namely: Skill; experience; Ethical value; Mindset; Reliability of audit methods; effectiveness of tools used; and technical support.

Based on the above statement, the seven points are used as indicators of audit quality in this study.

2.4 Reputation of the public accountant office

Reputation constitutes a psychological commitment of the members of the organization standardized into a common belief that in the end will reflect the attitudes of individuals (Levinthal, 1991). In other words, reputation is a corporate culture that determines the behavior of organization and individuals within it. Subsequently, Balmer and Greyser (2003) states that the reputation is built over time, based on what the organization did and how members of the organization have been behaving. While Herbig and Milewicz (1995) state that reputation is an estimate of the consistency over time of entity attribute. As Bartlett et al., (1993) stated that the office's reputation reflects the history of past actions that affect consumer expectations with respect to the quality offered. Furthermore, office's Reputation can be measured by two things: first, competence of the Public Accountant Office where it must have skills that include expertise in client industry (Arens and Beasley, 2012). Second, having excellences over other Public Accountant Offices is something characterizes owned by the Public Accountant Office (Herbig et al., 1994). Based on the previous description, the two terms are taken as indicators in this study.

2.5 Research Framework

The structure of the overall conceptual model is presented in Fig. 1. This model was developed from a review of literature broadly to refer to the audit quality research. The constructs of model are built from the search results to the literature and research findings that are considered relevant.

The description of the model is described as follows.

2.5.1 The effect of Public Accountant's Independence toward Audit Quality

Richard (2006) conducted a study to identify the independence of public accountant, where he tried to examine why it is difficult for auditor to be an independent in conducting the audit process with a case study on several companies in France. The results showed that the lower the level of independence will lead to audit quality decrease.

Furthermore, Arens and Beasley, (2012) states that public accountants strive to maintain a high

level of independence to maintain the trust of users who rely on their reports. The threat toward independence does not only happen when public accountant audit but also potentially affects the audit opinion (Dopuch et al., 2003). A similar view is also

expressed by Lindberg and Beck (2004) that the independence will help to provide quality assurance audits that are likely to enhance user's reliance on the financial statements resulted.

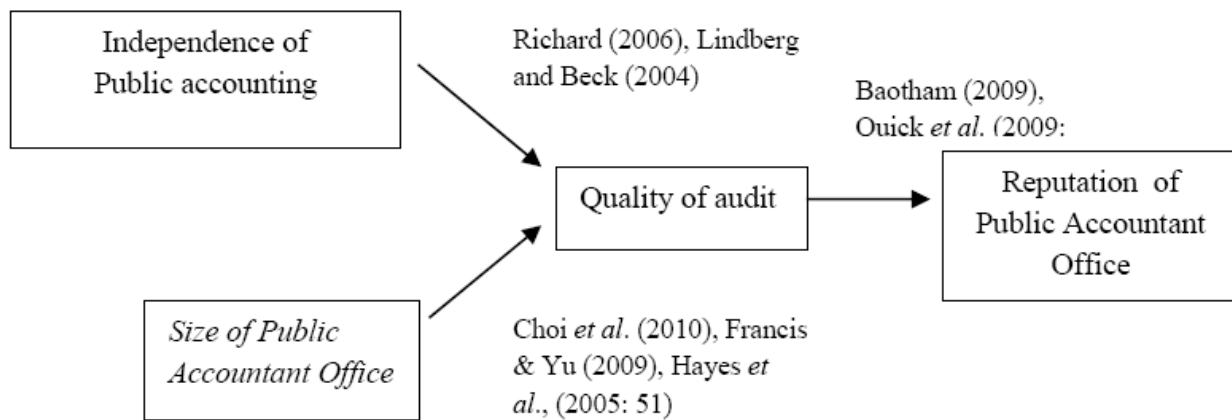


Fig. 1. Causal Model of Audit Quality.

Several explanations above are used as references for the formulation of hypothesis 1. Hypothesis 1 the independence of public accounting has effect on audit quality.

2.5.2 The Effect of Public Accountant Office Size toward Audit Quality

Choi et al., (2010) examined the effect of the size of Public Accountant Office, audit fees and audit quality in the United States for the period 2000-2005. The size proxies of Public Accountant Office used is seen from the number of clients handled and audit fees received. The results showed that the size of the Public Accountant Office has positive influence to the audit quality and the audit fee.

Furthermore, Francis and Yu (2009) conducted a study on the effect of Big 4 Office Size on audit quality. Francis tested prediction of Public Accountant Office size effects on audit quality by checking the sample of 6568 companies in the U.S. by observation year, period 2003-2005, with audited 285 public accountants who gathered in the Big 4. The results of this study stated that Public Accountant Office included in the big four produced high quality audit.

In line with what expressed by Hayes and Schilder (2005), namely: Big Four audit offices perform higher quality audits both in detection and independence than non-Big four offices, because they have a technological edge and because a given client will represent a smaller amount of their aggregate fee income.

Moreover, a Public Accountant Office is often synonymous with quality audits, as revealed by Lennox (1999). Lennox argues that the big Offices have a greater incentive to audit more accurately

because they have more specific relationship with the client (client-specific rents) that will go away if they provide inaccurate reports. Additionally, because of the size, the Public Accountant Offices have the resources or wealth greater than the small offices. So, it is obvious that the size of the Public Accountant Office is an inherently element that can't be apart from quality predicate.

2.5.3 The Effect of audit quality on public accountant office reputation

Baotham (2009) conducted a study of Public Accountant Office in Thailand to investigate the influence of independent public accountants, audit quality and reputation of public accountants, as for the results of the study showed that there is an influence of independence on audit quality and influences of audit quality on the reputation of Public Accountant Office. According to Baotha public accountant effort to provide quality audit services is a signal that public accountants try to build a reputation, in which a good reputation has competitive advantage to attract more clients to use their services (Garberg and Fombrun, 2002). A similar view is expressed by Quick et al., (2009), which states that the Public Accountant Office provides audit quality to protect their reputation and attract clients.

3. Conclusion

The efforts to continue to maintain and improve the audit quality are of the key factors in maintaining the sustainability of public accounting. The business of which can be manifested through the implementation of an independent attitude in conducting the audit, Size of Public Accountant Office and Public Accountant Office reputation. The

framework presented in this study is limited to the study of literature that has not proven to be actual. Therefore, further research is needed to obtain the empirical validation of the results of this study.

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