

## **The Effect of Quality Control System, Auditor Competence and Corporate Governance (as Moderating Variable) on the Audit Quality**

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**Abstract:** Some of the accounting scandals that occurred in the United States has caused a crisis of public confidence in the quality of audits produced by public accountants. Accounting scandals of Satyam Computer Services Limited Year 2011. Di Indonesia, auditing standards violations also occur. This study may be different from previous studies remember: this study used a reference framework audit quality issued by the IAASB, a framework for audit quality, key elements that create an environment for audit quality (2014) which uses the approach of input-process-output in assessing the quality of the audit. Among the input element is the knowledge, skills and experience (competencies). Framework for audit quality issued by the International Auditing and Assurance Standards Boards (IAASB) (a frame work for audit quality, key elements that create an environment for audit quality) provides an overview of the quality of audio that will be achieved by the audit team are knowledgeable enough, experts and experienced and have enough time allocated to perform the audit work.

**Key words:** Auditor competence, audit quality, auditor, information, enough time, framework,

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### **INTRODUCTION**

Achievement of quality audits by an audit team can be seen from the aspect of input, process and output aspect and interaction among stakeholders. Aspects of inputs including: values, ethics and attitudes have the knowledge, expertise and experience adequately and has allocated sufficient time to carry out audit work. From the aspect of the process of audit quality look of how the audit team implement the audit process and quality control procedures which comply with appropriate laws, regulations and standards while aspects of the audit report output (Independent Auditor's Report) presents the report useful and timely and appropriate interaction with relevant stakeholder. Auditors are required to comply with relevant auditing standards and quality control standards and comply with the public accounting firm of ethics and other rules. Some of the accounting scandals that occurred in the United States has caused a crisis of public confidence in the quality of audits produced by public accountants (Dang, 2004). Reputation public accountant in Indonesia (also), a lot of the spotlight that led to the public doubt the competence, independence and integrity. Roles and responsibilities of the public accounting profession is currently being questioned after the discovery of accounting scandals involving public accounting profession.

Scandals that occurred in other countries are: accounting scandals of Enron and WorldCom and several other public companies in the United States. Accounting scandals in Italy in 2003 on the company Parmalat finanziaria involving the firm Grant Thornton and Deloitte and Touche. Parmalat recorded fictitious sales and accounts receivable by using a double-billing scheme, reporting non-existent periodic asset in the balance sheet of the company. Deloitte and Touche considered reckless in conducting an audit of Parmalat. Lehman Brother publicized scandal in 2008 involving Earn and Young (E and Y). Lehman Brother which has assets of over US\$700 billion, apparently doing window dressing with understated on liability. In Lehman's financial statements of 2007, liabilities are lower by almost \$50 billion. Lehman intentionally doing window dressing on the financial statements. In addition, Lehman also did disclosure on accounting policies applied to the transaction repurchase agreement (REPO) in the financial statements.

Madoff securities publicized accounting scandal at the end of 2008. Madoff commit fraud by using Ponzi scheme. In this scheme madoff can share return to investors each year. The return is not really an advantage but is derived from the investment subsequent investors. Accounting Office Frierling and Horowitz, a local public accounting firm in New York City failing to conduct an

audit of the financial statements of Madoff. Accounting scandals Satyam Computer Services Limited in 2011, involving the public accounting firm Price Waterhouse Cooper (PWC). In such cases, PWC considered to have violated Generally Accepted Auditing Standards (GAAS), to conduct an audit of poor quality and not in accordance with GAAS which resulted detected accounting fraud in the company for several years, causing losses to the company's stakeholders. During the year 2013, the structural design of the firm quality control in Indonesia on elements of consulting, professional development and inspections that are in poor condition. In terms of the quality of the application of quality control system worst conditions are in the element of supervision, consultation and inspection. An important one in the audit process are personal attributes; expertise and experience of the auditor (ISAS, SA 220 was adopted), requires co-engagement (engagement partner) can be assured that the team commitment and each expert auditor who is not part of the team engagement, collectively have the competence and the corresponding ability to carry out the audit engagement and publish audit reports in accordance with the conditions.

Unless the information provided by the firm or other parties suggest otherwise, the engagement team can rely on the quality control system of the firm in connection with personal competence through recruitment and formal training. By relying on the audit standard-quality control for audit financial statements, auditor competence both acquired during formal education and the experience and expertise gained during the audit, especially on the same client (tenure), expected the audit process will be qualified to do the appropriate with auditing standards and produce audit reports with high quality. Audit quality is a concern users of financial statements, however there are a number fenomenan still presentation of financial statements that do not conform with generally accepted accounting standards but an independent auditor/Public accountant, gives an unqualified opinion. In 2014, the IAASB has published an audit quality framework, "A framework for audit quality, key elements that create an environment for audit quality". Auditors are required to comply with relevant auditing standards and quality control standards of public accounting firms as its terms of ethical standards and regulatory bodies demand.

According to this framework, the quality of an audit will be influenced by the input, process, output and interaction as described in terms of audit quality. IAASB audit of the quality framework, distinguishing element of audit quality as follows: inputs; process; outputs; key

interaction within the financial reporting supply chain; contactual factors. Input in terms of audit quality, values, ethics and attitudes of auditors influence internal culture of the firm and the knowledge, expertise and experience of the auditor (competence) as well as the time allocated to perform the audit. The audit process and quality control procedures influence to audit quality. While the output of an audit are often determined by the context including legislative requests. There are a number of factors contexts such as laws and regulations and corporate governance that could potentially affect the nature and quality of financial reporting and directly or indirectly affect the quality of the audit. Where the auditor adequately respond to these factors when assigning the best way to obtain sufficient appropriate audit evidence and convincing.

#### **Literature review**

**Audit quality:** Audit quality is a subject that affects either directly or indirectly. If you put the quality in the approach that directly, this perspective is not enough to answer the question which audit quality is achieved in a broader context. The quality of an audit will be influenced by the input, process, output and interaction as described in the audit quality framework. IAASB audit quality framework according to distinguish the following elements: input, process, outputs, key interaction within the financial reporting supply chain, (e) contextual factors. The use of Discretionary Accrual (DA) as a proxy for audit quality in previous studies have been done, including research conducted by Krishnan (2013), Jones *et al.* (2008). The financial performance is the relationship between income and expenses of the entity as presented in the income statement. Profit is frequently used as a measure of performance or as the basis for other measurements such as return level of investment or earnings per share. To be useful, the information of the information presented in the financial statements must be reliable, free of misstatement and bias and honest presentation of what should have served or are reasonably expected to be presented. No financial statements are free from bias (through election or presentation of information) if intended to influence the making of a decision or policy to achieve a specific outcome of interest. Income statements containing DA introducing bias and their manipulation of earnings. Decisions users of financial statements to be biased if the use of financial statements containing DA as a basis for decision making. Audit quality should be able to find any element of the bias and by considering the materiality, the

independent auditor will consider any modification to the audit report. High quality auditors have the experience, resources and encouragement to limit opportunistic reporting of accrual and bolstering confidence in the accrual (Krishnan, 2013).

## MATERIALS AND METHODS

**Auditor competence:** Auditor competence includes knowledge, skills and experience as outlined in the framework for audit quality, published by the IAASB in 2014 with the key attributes partner and staff competence, partners and staff understand the entity's business, partner and staff have the ability to make a logical judgment, co-engagement actively involved in the risk assessment, planning, supervision and review the work that has been carried out. The staff conducting field audits have adequate experience and directed properly, supervised and reviewed and there are professional education sustainable, partners and staff have enough time to handle the audit in a manner effectively, co-engagement and engagement of experienced team members to have access to management and parties have the responsibility. Competence, independence and due professional care, a cornerstone in auditing. All three affect the value and quality of the audit (Nowicki and Grusd, 2004). Competence relates to the technical ability of the auditor to find a misstatement in the financial statements and is a function of education, training and experience. Dutra *et al.* (2013), classifies the competence of auditors as follows:

- The intellectual skills
- The personal skills
- Good communication and interpersonal skills
- The organizational and business management skills

The results of the study Dutra *et al.* (2013) concluded that the perception of the auditee (40 trading companies registered with the SEC) on the competence of auditors are at level 3 (on a scale of 1-5). Auditee perception related to the auditor at a higher level (partner and audit manager) is higher than the perception of competence of the auditors on the lower level (Junior, senior and supervisor). And there are no significant differences of perception between the auditor's competence in the big-four and non big-four auditor. Competence is the skill, knowledge, talent and other personal characteristics that generate superior performance (Michael, 2010). Competence is a level of performance that demonstrate

the effective application of knowledge, skills and management. Yukl states that the main competence is the knowledge and ability to perform certain activities where the main competence usually consists of a combination of technical expertise and application skills.

Other literature mentions that competence was demonstrated knowledge and skills necessary to undertake certain activities to generate better performance (Sekaran and Bougie, 2011). According to the ISA, Auditing Standards ("SA") 220 on quality control for an audit of financial statements (Paragraphs A.11): when considering the appropriate competence and capabilities expected of the engagement team as a whole, the engagement partner may take into consideration such matters as the team's:

- Understanding of and practical experience with audit engagements of a similar nature and complexity through appropriate training and participation
- Understanding of professional standards and applicable legal and regulatory requirements
- Technical expertise, including expertise with relevant information technology and specialized areas of accounting or auditing
- Knowledge of relevant industries in which the clients operates
- Ability to apply professional judgment
- Understanding of the firm's quality control policies and procedures

Competence on the above matters within the competence of the engagement team as a whole therefore, includes competence engagement partner, audit manager and audit supervisor or incharge. Competence can be developed through a variety of methods including the following:

- Professional education. (In Indonesia, for example): accounting profession education, a special education program organized by college graduates earned an accountant
- Continuing professional education for accountants practice license holders are required to follow this continuing professional education at least 40 h/year
- Experience working as an auditor
- Coaching with lots of experienced staff
- Education independence required for personnel who become independent

Meanwhile, according to Law No. 5 of 2011, Article 6 the competency requirements that must be met to work as

a certified public accountant is to have a public accountant exam pass mark legitimate and experienced practice provides public accounting services. Requirements to be able to take the certification exams, CPAs is scholar Strata-1 (S1-Undergraduate). While the material certified public accountant exam (in Indonesia) consists of: auditing, theory and practice, financial accounting, theory and practice, business and commercial law, the accounting information system.

Audit quality framework published IAASB Paragraph 41 describes the key attributes of knowledge, expertise and experience and time at levels of engagement are as follows:

**Knowledge:** Partner and staff understand business entities.

**Expertise:**

- Partners and staff have the necessary competence
- Partner and staff make a reasonable judgment
- Assignment partners are actively involved in the risk assessment planning, supervision and review of audit work that has been done

**Experience:**

- Staff who carry out audit work in the field has sufficient experience, precisely directed, supervised and reviewed and there is a reasonable level on an ongoing basis
- Auditors and all team members involved in the audit have adequate experience and can make access to management and reviews Those Charged With Governan (TCWG)

The unit of analysis in this study is a public accountant which has been licensed practices and a license as a supporting profession of the capital market regulatory institutions (now FSA). Therefore, has a minimum competence required by laws and regulations as well as having knowledge of the capital markets. Thus, these competencies include knowledge partner and staff have the necessary competence.

## RESULTS AND DISCUSSION

**Quality control standards:** The element quality control standards, IAASB, ISQC 1, "Quality control for firm that perform audits and review of financial statement and other assurance and related services engagement" state the element of system of quality control are as follow:

- Leadership responsibilities for quality within the firm
- Relevant ethical requirement

- Acceptance and continuance of client relationship and specific engagements
- Human resources
- Engagement performance
- Monitoring

Quality control system, policies and procedures are the responsibility of the audit firm, under ISQC 1 (Par 11), the firm has an obligation to establish and maintain a system of quality control to provide it with reasonable assurance that:

- The firm and its personnel comply with professional standards and applicable legal and regulatory requirements
- Report issued by the firm or engagement partners are appropriate in the circumstances

**Corporate governance:** Corporate governance refers to the structures and processes for the direction and control of companies. Corporate governance concern the relationship among the management, board of directors, controlling shareholders. Corporate governance contributes to sustainable economic development by enhancing the performance of companies and increasing their access to outside capital. Corporate governance concern the system by wich companies are directedand controlled. It is about having companies, owners and regulators become more accountable, efficient and transparent which in turn builds trust and confidence. Well-governance companies carry low financial and non-financial risk and generate higher shareholder returns. Corporate governance framework (in Indonesia) base on: transparency, accountability, responsibility, independence, fairness and equalization. With reference to the hierarchy of the laws in Indonesia, these principles will be deployed in more concrete in various laws and regulation in Indonesia.

**Theoretical framework:** Three fundamental aspects of the quality of the audit are: input, output and contactual factors. There are a number of inputs that are part of a separate auditing standards an important one is the personal attributes, skills and experience of auditor (competence). The quality of an audit will be influenced by the input, process, output and interaction as described in the audit quality framework. Competence is a skill acquired through experience. Experience practicing as an auditor who shall be calculated from the corresponding obtain authorization practices as CPA and as a profession capital market support, assuming as effective training tool for auditors to improve competence. Expertise to understand the background and industrial

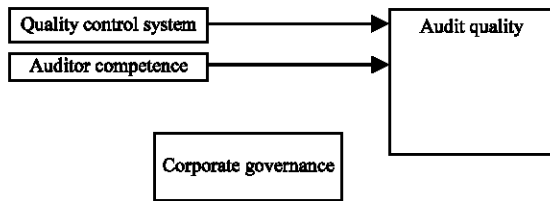


Fig. 1: Study model

clients, to understand the company internal control and audit strategy (Mansouri *et al.*, 2009; Halim *et al.*, 2014).

This study aimed to examine the effect of the quality control system of the firm and competence of auditors to audit quality. In addition this study also will look at the influence of corporate governance in moderating the relationship between the quality control system of the firms and competence of auditors with audit quality. As set out before that the control system aims to provide reasonable assurance that: the firm and its personnel comply with professional standards and reports issued by the firm or colleague engagement in accordance with the conditions. Thus, good or bad quality control system will affect the quality of the audit CPAs and firms on the financial statements. In Chapter 2 has described how many rules or requirements for someone to become an auditor. This is because the knowledge, skills and experience are the things that a person needs to be auditor competence. Competence of an auditor is very important because it will affect the quality of the audit. Application of corporate governance that ensures transparency of corporate information, protection of shareholders, stakeholders, roles and responsibilities of the board of commissioners and board of directors which provides motivation to the management of the company to present the financial statements better. Corporate governance practices have a strong positive influence on the reliability of the financial information presented by the company. Therefore, the influence of the quality control system of the firm and competence to audit quality will be determined by the practices of corporate governance. Thus, it can be stated that corporate governance practices moderating influence firms quality control system and competence to audit quality (Fig. 1).

## CONCLUSION

Competence is a skill acquired through experience. Experience practicing as an auditor computed from the corresponding obtain permit to practice as a public accountant and as a profession capital market support are

assumed to be an effective training tool for auditors to improve competence. Expertise to understand the background and industry clients, understand the company's internal control and audit strategy. (Mansouri *et al.*, 2009; Halim *et al.*, 2014). This study uses the DA as a proxy for audit quality (Krishnan, 2013, Jones *et al.*, 2008). Audit quality should be able to find any element of bias in the income statement due to discretionary accrual. By considering the materiality, the independent auditor will consider any modification to the audit report. High quality auditors have the experience, resources and encouragement to limit opportunistic reporting of accrual and bolstering confidence in the accrual (Krishnan, 2013). The quality of an audit influenced by input, process, output and interaction as described in the audit quality framework. High quality of auditors who can find a material misstatement in the financial statements and may reduce the information asymmetry between principal and agent and auditors can guarantee the interests of stakeholders. Auditor competence positively affect the quality of the audit. Application of corporate governance that ensures transparency of corporate information, protection of shareholders, stakeholders, roles and responsibilities of the board of commissioners and board of directors which provides motivation to the management of the company to present the financial statements better. Corporate governance practices have a strong positive influence on the reliability of the financial information presented by the company. Therefore, the influence of the quality control system of the firm and competence to audit quality will be determined by the practices of corporate governance. Thus, it can be stated that corporate governance practices moderating influence firms quality control system and competence to audit quality.

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