

# **Audit Quality: Client Importance, Audit Capacity Stress, and Audit Fee**

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## **Abstract**

This research aims to determine the effect of client importance, audit capacity stress, and audit fee both partially and simultaneously on audit quality. This research's population is financial companies listed on Indonesia Stock Exchange for the year 2016-2020. Purposive sampling was used as the research sampling technique. Therefore, the samples obtained were 50 financial companies for the period 2016-2020. Logistic regression was used in this research to analyze the data. Results of the hypotheses show that client importance, audit capacity stress, and audit fee affect audit quality simultaneously while only audit fee affects audit quality partially. This research adds to the limited number of samples and variables that could affect audit quality. It is suggested to do the next research with client importance as an independent variable on audit quality with a different measurement. The implications and recommendations will be discussed further in this research.

## **Keywords**

Audit Capacity Stress, Audit Fee, Audit Quality, Client Importance

## **1. Introduction**

The existence of differences of interest between two parties, management and shareholder, can cause the conflict of interest. The external auditors in this case are the middle party from the interests of two parties that are assigned to do evaluation and assess whether the financial report made by the management party is presented fairly and in accordance with existing standards (Febriyanti and Mertha 2014). The high-quality information in the financial report can be created by improving the audit quality (Salsabila 2018). Audit quality is the ability of the auditors in finding and reporting the finding of unintentional or intentional errors in the financial report of related entities and included in the audit opinion (Murti and Firmansyah 2017). In order to conduct the audit of financial reports, independent and competent auditors to make the audit are reliable by all of the interested parties (Ardani 2017). The competency of auditors is to preserve the professional knowledge and skills to ensure that clients receive the professional and competence service from the auditor (Tuanakotta, 2017:51). The independent auditors are auditors who work freely without any pressure as well as objectively (Gaol 2017). The term objective, according to Tuanakotta (2017:51) is impartiality, conflicts of interest or pressure from others to override professional and business judgments.

The competition in giving public accounting services makes the auditors obliged to stand in the fierce competition of the service world to gain the public's trust. The public's trust obliged the auditors to maintain the quality of the given audit to be held accountable (Novrilia et al. 2019). However, there are still some cases found regarding audit quality that reduce the trust of financial reports' users in the audit result.

The first case regarding the audit quality of the financial sector occurred at Sunprima Nusantara Finance Incorporated. The Financial Services Authority (OJK) imposed sanctions in the form of cancellation of registration to 2 public accountants (PA) and the public accounting firm (PAF) related, that is one of Deloitte's affiliates. The administrative sanctions imposed because both PA and PAF related were claimed did not give a reasonable opinion on the actual condition. The financial report at SNP Finance Inc. in the year 2018, which PA and PAF audited related, gained an opinion of Unqualified, whereas, according to the audit result of OJK, SNP Finance Inc. was indicated had presented a financial report that was not reflecting the real condition of the company's finance which led to a loss for many parties (Wareza 2018).

The second case occurred at the Jiwasraya Insurance Incorporate. This case occurred in 2006 when Jiwasraya recorded the pseudo profit based on the records of the Supreme Audit Agency (BPK). The Ministry of State-Owned Enterprises and FSA stated that the equity of Jiwasraya was recorded as unfavorable at IDR 3,29 trillion. In 2008, BPK gave a disclaimer opinion (not stating an opinion) for Jiwasraya's financial report in 2006-2007 (CNN Indonesia 2020). In 2015, Jiwasraya released a product of the JS Saving Plan with an extremely high cost of the fund over interest on deposits and bonds. However, this cost was invested in the low-quality stocks and mutual funds; thus, Jiwasraya experienced loss due to the products of JS Saving Plan until 2018, which led to the difficulty in paying for the customer policy of JS Saving Plan as much as IDR 802 billion. In contrast, in the annual report period of 2016, Jiwasraya received an audit opinion of Unqualified from PricewaterhouseCoopers (PwC) PAF, which PAF appointed as the external auditor in evaluating the financial report of 2016. This case further involves many parties, including an external auditor, because it is claimed that they cannot detect the company's actual circumstances.

There are various aspects that can have an impact on the audit quality. The first one is client importance. According to Suciana and Setiawan (2018), client importance is the biggest client owned by auditors, and the auditors tend to spend a longer time with the client party. Another definition of *client importance*, according to Wahyuni and Fitriany (2012), is the importance of the client's finance on related PAF, therefore the more significant the client is to the auditors/PAF, the worse the audit quality will be as a result of economic dependency. It is supported by a research conducted by Wahyu (2020) where client importance has an influence on audit quality which stated that auditors tend not to report if there is fraud or irregularities in the client's financial report because the auditor thought that if they were reported, then they will reduce their income and the client would not use their service again. Based on the research by Udayanti and Ariyanto (2017), client importance has no effect on audit quality. The study's findings indicated that the auditors considered that all of their clients did not have any effects on the produced audit quality.

The second aspect that can have an impact on audit quality is audit capacity stress. Audit capacity stress, which is also known as the workload, is a busy time for auditors at the beginning of the year due to the number of audit assignments that auditors must do at that time. A number of clients in a PAF or PA will affect the auditors' performance in managing the time to process the audit, whereas the audit quality is reflected in how the work or audit process is conducted (Yolanda et al. 2019). The workload can cause the emergence of dysfunctional audit behavior, which can reduce the auditors' skill in finding errors or reporting deviations (Pertiwi and NR 2020). Research on audit capacity stress or workload has not been done much, especially in financial sectors. One of the researches on audit capacity stress was conducted by Suryawan and Priantara (2021) stated that audit capacity stress has no effect on audit quality. A high workload in a PAF is not influencing the audit quality produced by the auditors. In the research of Fadhilah and Halmawati (2021), audit capacity stress negatively affects audit quality. The quality of the produced audit decreases as the workload of the auditor increases.

The audit fee is the third aspect that can have an impact on audit quality. A cash payment made to or received from a client or other entity in exchange for their engagement is known as an audit fee or audit cost (Agustini and Siregar, 2020). The total audit fee must be determined by taking into account the clients' needs, legal obligations and responsibilities, independence, level of skill and responsibility related to the job performed, the level of complexity of the task, the amount of time required for the PA to successfully use to complete the work, and the reason for determining the agreed cost. (Qintharah 2020). Higher audit fees will improve audit quality because audit fees acquired in a single year and expected operational expenditures to undertake the audit process can improve audit quality. (Andriani and Nursiam 2018). The statement is in accordance with the research conducted by Novrilia et al. (2019) where audit fee does not have any significant result on audit quality. This is so because the audit fee is unable to determine whether an audit's quality will be good or bad.

The inconsistencies in the three factors makes the researcher want to research those factors to be further researched and reviewed.

## **1.1 Objectives**

The objectives of this research are as follows:

- To find out client importance, audit capacity stress, audit fee and audit quality on financial companies listed on the Indonesia Stock Exchange for the years 2016-2020.
- To examine the simultaneous effects of client importance, audit capacity stress, and audit fee on audit quality for financial companies listed on the Indonesia Stock Exchange for the years 2016 to 2020.
- To determine the partial effect of:

- a. Client importance on audit quality on financial companies listed on Indonesia Stock Exchange for the years 2016-2020.
- b. Audit capacity stress on audit quality on financial companies listed on Indonesia Stock Exchange for the years 2016-2020.
- c. Audit fee on audit quality on financial companies listed on Indonesia Stock Exchange for the years 2016-2020.

## **2. Literature Review**

### **2.1 Agency Theory**

According to Suciana and Setiawan (2018), agency theory defines an agency relationship as a contract in which one or more people (principals) hire people (agents) to perform services on behalf of the principal, engaging the agent in decision making. The link between shareholders as the primary and management as the agent is explained by agency theory. The importance of the company's owner (shareholders) delegating administration of the company to experts known as agents who are more knowledgeable in managing the day-to-day operations is emphasized by agency theory. By managing the business with qualified staff, owners may maximize profits at the lowest feasible cost. This is the goal of separating management from ownership (Wahyu 2020).

### **2.2 Audit Quality**

Andriani and Nursiam (2018) define audit quality as the probability of auditors finding and reporting violations of the client's accounting system. The high-quality audit result can influence the image of the relevant Public Accounting Firm (PAF), where audit quality consists of clarity of information from the results of the audit conducted by the auditors on the audited client's financial statements under applicable auditing standards. In doing their jobs, auditors are guided by auditing standards set by IAI (Indonesian Accountants Association) to maintain audit quality (Kamil, 2021). Based on IAI, professional accountants are required under the international code of ethics for accountants to uphold five fundamental principles: professional accountants must not be swayed by personal ideas, integrity, professionalism, and the ability to maintain confidentiality (Pamungkas and Gantyowati 2021).

### **2.3 Client Importance**

Client importance is the importance of the client's relative financial towards PAF continuity (Kerler and Brandon, 2010). The length of the client-auditor engagement has the ability to make the company a significant or important client (client importance) because it becomes a source of income for the auditors and PAF. Auditors who consider their clients the potential finance source will affect the emergence of economic dependence on the audit quality produced by auditors (Devi et al., 2019). According to Wahyu (2020), the more important clients for auditors/PAF, the lower audit quality due to the existence of economy-dependent factors.

The notion corresponds to the findings of Chen et al. (2016), Devi et al. (2019), and Wahyu (2020), where client importance negatively affects audit quality. Auditors tend to agree with the requests of clients who are considered the main clients or important clients because the auditors assume that the company will continue to employ them. Pamungkas and Gantyowati (2021) stated that auditors would be careful if their main clients are big companies because auditors or relevant PAF will be very careful in doing their jobs. If something goes wrong, it might damage the auditors' and PAF's reputations. Auditors are afraid if they make mistakes or fail to audit the main clients' financial statements because the main clients or companies that have more significant assets tend to have more public attention than ordinary clients.

**H<sub>1</sub>: client importance negatively affects the audit quality.**

### **2.4 Audit Capacity Stress**

Audit capacity stress is a condition where there is an imbalance between the numbers of clients that must be handled with the time for completion of the audit so that it affects the quality of the audit produced (Suryawan & Priantara, 2021). According to Yolanda et al. (2019), audit capacity stress is the workload faced by auditors that will make auditors difficult to allocate time to carry out the audit process. Audit capacity stress is also called workload. The workload is defined as the amount of work that can cause the emergence of dysfunctional audit behavior, which leads to a decrease in auditors' skills in finding mistakes or reporting deviations from the related clients' financial reports (Pertwi and NR, 2020). Julia et al. (2019) stated that a high level of workload could lead to a decrease in audit quality due to the increase in auditor working hours which is at the peak of the busy season.

The statement is in line with research conducted by Pertiwi and NR (2020), and Fadhilah and Halmawati (2021) where audit capacity stress or workload has a significant negative effect on the quality of the resulting audit. The quality of the audit will deteriorate as the auditor's workload increases, and vice versa.

**H<sub>2</sub>: Audit capacity stress negatively affects the audit quality.**

## **2.5 Audit Fee**

The amount charged by external auditors as compensation for their work as evaluators of the fairness of customers' financial reports is known as the audit fee. The complexity of the service, the assignment's risk, the public accountant's cost structure, the level of experience, and other professional considerations are some of the elements that PAF takes into account when setting the audit price (Darmawan and Ardini 2021). The audit fee is an essential thing in the checking quality of the financial reports of a company. The high audit fee makes the extent of the audit procedure. The breadth of this audit procedure allows client errors to be detected. The broad scope of audit procedures will result in high audit quality, making audit results a reliable source (Novrilia et al., 2019).

The statement above is in line with some previous research, such as those conducted by Ardani (2017), Andriani and Nursiam (2018), Darmawan and Ardini (2021), and Kamil (2021), where the audit fee positively affects the audit quality produced by auditors. Higher audit fees will increase audit quality because the audit fee acquired in a year and the estimation of operational financing required to perform the audit process can improve audit quality (Kamil 2021). If the audit fee obtained is high, then the audit quality produced will be higher because of the wider audit procedures carried out by the auditor (Salsabila, 2018).

**H<sub>3</sub>: Audit fee positively affects the audit quality.**

## **3. Methods**

### **3.1 Population and Samples**

Population in this study is the financial companies listed on the Indonesia Stock Exchange for the period 2016-2020, as many as 84 companies and samples obtained were 50 companies. The sampling is by using the purposive sampling technique where there are several criteria in selecting the sample, namely (1) financial companies listed on the Indonesia Stock Exchange for the period 2016-2020, (2) financial companies that consistently publish audited annual reports for 2016-2020, (3) companies that have data related to this research variables.

### **3.2 Measurement of Variables and Regression Models**

#### **a. Audit Quality**

In this study, the audit quality is measured using earning surprise benchmarks, which draws on a number of other studies, including Novrilia et al. (2019), Wibowo and Rossieta (2009), and Yendrawati et al. (2021). Return on asset (ROA) is used as a measure of audit quality. Earning benchmarks used are  $\mu - \sigma < ROA < \mu + \sigma$ , where  $\mu$  is the average of ROA in all samples and  $\sigma$  is its standard deviation. This research uses dummy as audit quality proxies, and their criteria are as follows:

KA = 1, if  $\mu - \sigma < ROA < \mu + \sigma$ , it means that the audit quality of a company is high.

KA = 0, if  $ROA > \mu + \sigma$  or  $ROA > \mu - \sigma$ , it means the company is doing windows dressing (if  $ROA < \mu + \sigma$ ) or taking a bath (if  $ROA > \mu - \sigma$ ).

#### **b. Client Importance**

In this study, the client importance is measured in relation to a number of earlier studies, including those carried out by Chen et al. (2016) and Udayanti and Ariyanto (2017).

$$CI = \frac{SIZEit}{\sum_{i=1}^n SIZEit}$$

Where:

CI : Client importance

SIZEit : i client's total asset in natural logarithm

$\sum_{i=1}^n SIZEit$  : The sum of total asset (in natural logarithm) of n clients that were audited by i public accounting firm in a certain year (t)

#### **c. Audit Capacity Stress**

This study's measurement of audit capacity stress refers to prior studies such as those conducted by Ishak et al. (2015), Hansen et al. (2008), and Yolanda et al. (2019).

$$ACS = \frac{\text{Total of public accounting firm's clients}}{\text{Total of public accountant of the firm}}$$

d. Audit Fee

This study makes reference to a number of earlier studies, including those carried out by Andriani and Nursiam (2018), Pramaswaradana and Astika (2017), and Salsabila (2018).

$$AF = Ln(\text{Professional Fees})$$

#### 4. Data Collection

The researcher acquired research-related data from the companies' audited annual reports on the Indonesia Stock Exchange's official website and from each company in this study.

#### 5. Results and Discussion

For the 2016–2020 study period, 250 observational data were gathered from 50 financial companies listed on the Indonesia Stock Exchange. The researcher then found the outlier data using the casewise list studentized method in the logistic regression analysis in the SPSS version 26. The outlier data in this research is as many as 11 observation data from 7 companies; thus, the final observation is obtained as many as 215 data from 43 companies.

##### 5.1 Descriptive Statistics

a. Nominal-scaled variable

Table 1. Descriptive Statistics of Normal-Scaled Variable

		AQ			
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Jika Kualitas Audit rendah	11	5.1	5.1	5.1
	Jika Kualitas Audit tinggi	204	94.9	94.9	100.0
	Total	215	100.0	100.0	

*Source: Output SPSS version 26*

The table above shows that from 215 observation data, it is obtained as many as 5,1% or 11 samples have low audit quality where the auditors gave the companies chances to practice window dressing or taking a bath. In contrast, there are 94,9% or 204 samples that have a high audit quality.

b. Ratio-scaled variables

Table 2. Descriptive Statistics of Ratio-Scaled Variables

Descriptive Statistics					
	N	Minimum	Maximum	Mean	Std. Deviation
CI	215	.76	1.00	.9293	.06524
ACS	215	1.00	3.00	1.6486	.67899
AF	215	18.46	29.07	23.0519	2.10978
Valid N (listwise)	215				

*Source: Output SPSS version 26*

Based on the table above, the client importance variable ranges from a minimum value of 0.76 to a maximum value of 1. The average value of this variable is 0,9293, and the standard deviation is 0,6524. The audit capacity stress variable ranges from a minimum value of 1 to a maximum value of 3. The average value of this variable is 1,6486, while the standard deviation is 0,67899. A minimum value of 18,46 and a maximum value of 29,07 are assigned to the audit fee variable. This variable has an average value of 23,0519 and a standard deviation of 2,10978. The three independent variables in this research have a higher average value than the standard deviation. It means that the spread of the data is homogeneity or does not vary.

## 5.2 Overall Fit Model

Table 3. Overall Fit Model

Block	-2LogLikelihood (-2LogL)
0	86,828
1	61,639

Source: Output SPSS version 26

The value of -2LogL in block 0 is 86.828 and the value of -2LogL in block 1 is 61.639. The fact that the value of -2LogL decreased from block 0 to block 1 shows that the proposed model fits the data, and that the inclusion of independent variables enhances the model's fit.

## 5.3 Goodness of Fit Test

Table 4. Goodness of Fit Test

Hosmer and Lemeshow Test			
Step	Chi-square	df	Sig.
1	1.056	8	.998

Source: Output SPSS version 26

The goodness of fit test results is obtained in the Hosmer and Lemeshow Test. The significant value in table 5.4, which is 0,998, this indicates that the null hypotheses ( $H_0$ ) cannot be rejected also, the model is able to predict the observation value, and there is no discrepancy between the model and observation value.

## 5.4 Coefficient of Determination

Table 5. Coefficient of Determination

Model Summary			
Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	61.639 <sup>a</sup>	.111	.333

a. Estimation terminated at iteration number 10 because parameter estimates changed by less than ,001.

Source: Output SPSS version 26

Nagelkerke's R Square, which indicates the coefficient of determination, or the ability of independent variables to explain the variability of the dependent variable, is 0.333. This indicates that the independent variables of client importance, audit capacity stress, and audit fee can account for 33,3 percent of the variation in the dependent variable of audit quality while the remaining 66,7 percent can be accounted for by other variables not being investigated in this study.

## 5.5 Logistics Regression Model

Table 6. Logistics Regression Model

Variables in the Equation							
		B	S.E.	Wald	df	Sig.	Exp(B)
Step 1 <sup>a</sup>	CI	-7.289	9.303	.614	1	.433	.001
	ACS	3.794	3.140	1.460	1	.227	44.449
	AF	.479	.205	5.465	1	.019	1.615
	Constant	-5.109	11.496	.197	1	.657	.006

a. Variable(s) entered on step 1: CI, ACS, AF.

Source: Output SPSS version 26

The equation of the logistic regression model based on the table above is as follows.

$$\ln \left( \frac{AQ}{1-AQ} \right) = -5.109 - 7.289CI + 3.794ACS + 0.479AF + \varepsilon$$

Notes:

- AQ : Audit Quality
- CI : Client Importance
- ACS : Audit Capacity Stress
- AF : Audit Fee
- $\varepsilon$  : Error

The estimated value contained in the logistic regression equation above can be interpreted from the B value in table 5.6 above. The interpretation of the value of B is as follows.

- a) Constanta ( $\alpha$ ) of -5.109 indicates that the audit quality, the dependent variable, will fall by 5.109 if the independent variable is assumed to be constant.
- b) The client importance variable regression coefficient is -7.289. It means that if there is a decrease in client importance by one unit and the other variables are constant, then the audit quality variable will decrease by 7.289.
- c) The regression coefficient of the audit capacity stress variable is 3.794. It means that if there is an increase in audit capacity stress by one unit and the other variables are constant, the audit quality variable will increase by 3,794.
- d) The audit fee variable's regression coefficient is 0.479. In other words, if the audit charge is raised by one unit and the other variables remain the same, the audit quality variable will rise by 0.479.

## 5.6 Omnibus Tests of Coefficients

Table 7. Omnibus Tests of Coefficients

Omnibus Tests of Model Coefficients		Chi-square	df	Sig.
Step 1	Step	25.189	3	.000
	Block	25.189	3	.000
	Model	25.189	3	.000

Source: Output SPSS version 26

Based on table 5.6, the value of chi-square is 25.189 with a significance value is 0.000 lower than the significance level  $\alpha = 5\%$  or 0,05. This means that client importance, audit capacity stress, and audit fee simultaneously affect audit quality.

## 5.7 Partial Test

The explanation of the partial test results based on table 5.6 is as follows.

- a) The significance value of the client importance variable is 0.433. It means that the significance value is greater than the significance level  $\alpha = 5\%$  or 0.05. As a result, the audit quality is partially unaffected by the client importance variable because  $H_{01}$  is approved and  $H_{a1}$  is refused.
- b) The significance value of the audit capacity stress variable is 0.227. It means that the significance value is greater than the significance level  $\alpha = 5\%$  or 0.05. As a result,  $H_{02}$  is approved and  $H_{a2}$  is refused which means partially, the audit quality is unaffected by the audit capacity stress variable.
- c) The audit fee variable has a significance value of 0.019. It indicates that the significance value is less than the  $\alpha = 5\%$  or 0.05 significance level. Thus,  $H_{03}$  is refused and  $H_{a3}$  is approved so that partially, the audit fee variable influences audit quality.

## 6. Conclusion

The audit quality in financial sector companies listed on the Indonesia Stock Exchange for the years 2016 to 2020 is simultaneously influenced by client importance, audit capacity stress, and audit fee. In contrast, during the years 2016 to 2020, the only factor affecting the audit quality in financial sector companies listed on the Indonesia Stock Exchange is the audit fee.

The recommendation for PAF and the management party is to pay attention to and evaluate the factors of audit fees and companies' financial performances that can influence the high and low audit quality. For academics, it is expected to increase knowledge and information about audit quality and the factors that influence it. Further research will be discussed in the following paragraph, which is also related to the limitations of this research.

This research has some limitations, such as the total of limited samples of 50 financial companies for the period 2016-2020. For further research, it is expected that the researchers can add the number of research objects from other sectors. Another limitation is on the total number of independent variables, and it is expected in further research to add more variables that have probabilities in influencing audit quality. Another limitation is that it is expected for the further research to use different proxies for measuring each variable, like discretionary accruals or audit adjustments for audit quality, the ratio of a company's total sales to the total sales of all companies signed by partners in observation for client importance, size of audited clients for audit capacity stress, and the actual total audit costs incurred by the companies which are listed in the companies' annual reports.

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