

The Correlation of Audit Fee, Audit Quality and Integrity of Financial Statement

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Abstract

This study aims to determine the effect of audit quality and audit fees on the integrity of financial statements with audit fees as moderating variable on audit quality. The population in this study was 78 companies listed on the Indonesia Stock Exchange in the 2014-2016 periods. The data analysis technique used was Moderated Regression Analysis (MRA). The result shows that audit quality does not significantly influence the financial statement integrity; while, audit fees have a positive effect on the integrity of financial statements. Then, the audit fee variable is not able to moderate the effect of audit quality on the integrity of financial statements.

Keywords: Integrity of financial statements, audit quality, audit fees

Introduction

Audit fee is becoming an issue when auditor uses it to control audit quality. In some cases, higher audit fee will lead auditor to work on audit harder and resulted to better audit opinion. Whereas some clients have to pay higher audit fee more than they should pay to get audit opinion as expected. Audit quality will impact to client's integrity of financial statement. In fact, audit will give assurance to management financial report and finally will increase its integrity on users view. This research, therefore, will investigate the influence of audit quality on financial statement integrity with audit fee as a moderating variable on audit quality. Research on this area is necessary to determine the influence of audit fee toward audit quality that has potential to erode public confidence in the integrity of financial statement.

The recent audit case in Indonesia involves Deloitte in the case of Medium Term Notes (MTN) Defaults from SNP Finance (Infobanknews.com., 2018). The examinations were indicated the negligence of the firm in Auditing the SNP financial statement. This case is shocking because Deloitte is a big four firm with high reputation and indubitably has high audit fee. This far, audit fees are often associated with firm audit quality. However, this case shows that high audit fee do not necessarily result in good audit quality and vis-à-vis the integrity of company financial statement.

Low or high audit fee may cause conflicting to audit performance. Audit fee is the cost incurred to an auditor for audit services rendered. Auditors have to be cautious for negotiations in audit engagement to avoid any issue that may ruin auditor professional judgment. Eshlesman & Guo (2013) suggest that clients paying abnormally low audit fees are receiving inferior audits. While higher audit fee is a signal that auditor may be losing her independents. A reasonable audit fee will lead auditor to perform adequate auditing procedure. Thus, judgment of opinion given by auditor is taken based on true condition underlying the financial statement (Harahap et.al., 2018).

Prior literatures show the relationship of audit fee toward audit quality. It seems reasonable that more audit hours with a good reputation firm will lead to higher audit fees and finally result higher audit quality. (Kuntari et.al., 2017) and (Abdul-Rahman et.al., 2017) find that audit fees have significant positive effect on audit quality. Khadash et al (2013) indicate a positive and significant correlation between audit quality and audit efficiency, the reputation of auditing office, auditing fees, the size of audit firm, and the proficiency of auditor. In this study, audit quality is measured by firms size, that is big-four audit firm and non big-four. Using firms size as a proxy of audit quality has been used by Kuntari et. Al., (2017), Abdul-Rahman et.al., (2017), Kimeli (2016) and Sawan & Alsaqqa (2013).

Audit quality gives assurance to users about the reliability of the financial reporting. Nwanyanwu (2017) defines audit quality as procedures established by auditor to ensure the relevancy and the reliability of financial report to organization members and public. Some literatures indicate the satisfactory level of audit quality is more evident in large audit firms than the small one (Kimeli, 2016; Sawan & Alsaqqa, 2013). Big 4 audit firms charged higher audit fees for staffing and geographical coverage, high reputation gained from several years' experience and industry specialization. Sawan & Alsaqqa (2013) argues that big four firms are superior than non-big four counterpart in reputation issue, resources and audit technology, higher number of clients and motivation to perform as professionally as possible.

Integrity on financial statement shows the value of a company that can influence the decisions of investors, creditors and other users of financial statements. Mayangsari (Beaver & Ryan, 2005) 2003 defines the integrity of financial statements to the extent of which the financial statements presented the reliability of information. Some studies suggest several factors that may effect the integrity of financial statement in Indonesia. Nurdiniah & Pradika (2017) finds that the independent commissioners and the size of company influence integrity of financial statement, while audit committee, institutional ownership and leverage do not give any affect. (Adriansano & Nuryantoro, 2015) show that auditor independence and audit quality do not give significant influence toward integrity of financial statement, while managerial ownership effect significantly.

Audit quality is considered as an essential factor affecting the integrity of financial information. Whereas, some literatures found the correlation of audit fee and audit quality. Puspita & Utama (2016) find that audit quality and audit fees have a positive effect on the integrity of financial statements in manufacturing companies in Indonesia. While the audit fee variable is not able to moderate the effect of audit quality on the integrity of financial statements. Research by Puspita & Utama (2016) has inspired this study to conduct the similar study on companies listed in Indonesian stock exchange. This study is enlarged by seeing the case not only in manufacturing companies but in all companies listed. The researchers are interested to examine the relationship of audit quality on integrity of financial statement, while audit fee as moderating variable of audit quality. This research will provide an evidence of whether audit fee influencing audit quality done by big-four and non-big-four audit firms. Furthermore, this study also proves the effect of audit quality on the integrity of company financial statement. However, the following are the hypothesis of the study:

H1: Audit quality has a positive effect on the integrity of financial statements.

H2: Audit fees have a positive effect on the integrity of financial statements.

H3: Audit fees strengthen the influence of audit quality on the integrity of financial statements.

The remainder of this paper is organized as follows. The next section presents the method and followed by results and discussion. The final section concludes the paper by recommending some suggestions for future research.

Methods

This research is aimed to know the effect of audit quality and audit fees on the integrity of financial statements. Moreover, it also examines the audit fee as moderating variable that influence audit quality on the integrity of financial statements. Data is taken from Indonesia Stock Exchange (ISE). This study used 78 companies listed in ISE as sample. The number of companies examined is less than expected due to incomplete information available in the company's annual report. Furthermore, the independent variable is the integrity of financial statement (Y). Integrity of financial statement is measured by using conservatism index that is Market to Book Ratio stated by Beaver & Ryan (2005). Market to Book Ratio is used rather than others conservatism index because it has data availability higher in company's annual report. The dependent variables used in this study are Audit Quality (X1). Audit quality is measured by the size of accounting firm that is big-four and non-big-four audit firms. For big-four audit firms or an affiliates will be given a score 1 while non-big four is given a score of 0 (Dummy variable). Then, the moderating variable in this study is the amount Audit Fee (X2) stated in company's annual report. The data source in this study is the annual report that has

been audited by CPA firm year 2014-2016. The analysis technique used in this study is Moderated Regression Analysis (MRA).

Results

In this study the number of sample observations was 78 companies multiplied by 3 years to 234 companies examined. From the table above, it is known that the sig value is 0.48 with the F value of 2.671. Thus, it can be concluded that the model can be used in this study.

Table 1 ANOVA

ANOVA ^b						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	32.115	3	10.705	2.671	.048 ^a
	Residual	921.750	230	4.008		
	Total	953.865	233			

a. Predictors: (Constant), X1X2, audit fee, audit quality

b. Dependent Variable: Financial Statement Integrity

Data processed 2018)

The table 2 following shows that audit quality does not significantly influence the financial statement integrity with a sig value of 0.343. This value is far above 0.05. Furthermore, the audit fee has a significant positive effect on financial statement integrity with a sig value of 0.008. This value is far below 0.05. From the table above it can be seen that the existence of audit fees as moderating variables has no significant effect on the audit quality with a sig value of 0.767. This value is far above 0.05.

Table 2 Coefficients^a

Coefficients ^a						
Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	-5.088	2.760		-1.843	.067
	Audit Quality	-.778	.819	-.188	-.950	.343
	Audit Fee	.371	.139	.220	2.658	.008
	X1X2	.012	.040	.060	.296	.767

a. Dependent Variable: Financial Statement Integrity

Data processed 2018)

Based on the table 3 following, it is known that the adjusted R square value is 0.021. It means that the independent variable influencing the dependent variance is 2.1%. While the rest are influenced by other variables that are not examined in this study.

Table 3 Model Summary

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.183 ^a	.034	.021	2.00190

a. Predictors: (Constant), X1X2, Audit Fee, Audit Quality

Data processed 2018)

From the hypothesis testing, it is found that only the second hypothesis is accepted. That is the audit fee has a significant positive effect on financial statement integrity. This result is similar with the research done by Puspita & Utama (2016) who found that audit fees have a positive effect on the integrity of financial statements in manufacturing companies in Indonesia. Audit fee is the cost incurred to an auditor for audit services rendered. Auditing fees consist mainly of the wages and benefits of office and field personnel, travel costs, and other costs necessary to the audit and related support activities (Al-Khaddash, Al Nawas, & Ramadan, 2013) . With more audit fee, the auditors

have many resources to gather evidence, verify the evidence and evaluate evidence to convince themselves of the integrity of the client's financial reports.

The first hypothesis that is the influencing of audit quality toward financial statement integrity shows insignificantly result with a sig value of 0.343. The results of this study are in accordance with the study conducted by Adriansano & Nuryantoro (2015) that is audit quality do not give significant influence toward integrity of financial statement. While, Puspita & Utama (2016) found that audit quality have a positive effect on the integrity of financial statements in manufacturing companies in Indonesia. Nwanyanwu (2017) defines audit quality as procedures established by auditor to ensure the relevancy and the reliability of financial report to organization members and public. Thus, as in theory, good audit quality should lead to higher financial statement integrity.

The third hypothesis, audit fees are found insignificantly to strengthen the audit quality on the integrity of financial statements. In other words, audit fees fail to moderate the audit quality. It is in line with the study conducted by Puspita and Utama (2016) who found that audit fee variable is not able to moderate the effect of audit quality on the integrity of financial statements. While, the research done by Kuntari et al. (2017) and Abdul Rahman (2017) found that audit fees had significant positive effect on audit quality.

Prior literatures show the relationship of audit fee toward audit quality. It seems reasonable that more audit hours with a good reputation firm will lead to higher audit fees and finally result higher audit quality. In this study, audit quality is measured by firms size, that is big-four audit firm and non big-four. Using firms size as a proxy of audit quality has been used by Kuntari et. Al., (2017), Abdul-Rahman et.al., (2017), Kimeli (2016) and Sawan & Alsaqqa (2013). However, this study finds no correlation between audit fees and audit quality. It means, higher or lower the fee audit will not give any influence on audit quality given by the CPA firms. Higher audit fee is having by the largest firms, like big-four CPA Firms. It makes sense that big 4 audit firms charged higher audit fees for staffing and geographical coverage, high reputation gained from several years' experience and industry specialization. Audit quality is not just affected by the size of audit firm. In fact, there are many factors contributes, as auditor qualification or the company's internal control system. However some regulators and small audit firms claimed that audit firm size does not affect audit quality and therefore should be irrelevant in the selection of an auditor. Pham et.al., (2017) found that Big 4 auditors in Vietnam provide high audit quality than non-Big 4 auditors. Interestingly, except for the audit firms in the Big 4, the findings suggest that smaller audit firms provide better audit quality in Vietnam context.

Audit quality is often associated with the size of the firm. Some literatures indicate the satisfactory level of audit quality is more evident in large audit firms than the small one (Kimeli, 2016 and Sawan & Alsaqqa, 2013). Sawan & Alsaqqa (2013) argue that big four firms are superior than non-big four counterpart in reputation issue, resources and audit technology, higher number of clients and motivation to perform as professionally as possible. However, this study shows different result. Audit quality does not give any influence on financial statement integrity. DeANGELO (1981) argues that as long as auditors maintain their professional standard and qualifications, it is not fair to distinguish them from other largest CPA firms. Thus, big-four CPA firms or non-big-for or large Firms or small firms are not indication of giving higher audit quality. Furthermore, the audit quality is not depending on audit firm size, even when auditors initially possess identical technological capabilities as big-four firms have. The discovery of misstatement measure to increase company's financial statement integrity is merely determined by auditor's knowledge, ability and their incentives to disclose (De Angelo, 1981).

Conclusions

Based on the results and analysis above, this study indicates that audit fee has a significant positive effect on financial statement integrity. While audit quality has no correlation on integrity of financial statements. Moreover, audit fees are failed to influence audit quality on the integrity of financial statements. In other words, audit fee variables are not able to moderate the effect of audit

quality on the integrity of financial statements. The amount of audit fees does not affect the audit quality given by CPA's firms. Audit fees are not taken into consideration since auditor examines clients' financial statement with professional standard and qualifications. Audit quality given by big-four or non-big-four CPA's firms are found not to have any correlation on financial statement integrity. It is because; the audit quality is not depending on audit firm size, even when auditors initially possess identical technological capabilities as big-four firms have. The auditor must have independent qualifications and do audit as standard required to give opinion to increase clients' financial statement integrity. For future research, it is suggested to research other factors that may influence the financial statement integrity. It can be also an area of research to seek some factors that may influence or determine the audit quality and audit fee.

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