

Recommendation of Quality Control Policies and Procedures for Audit Engagement at PAF X (Medium-Sized Public Accounting Firm)

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Abstract—This research aims to understand the impact of leadership responsibilities for quality within a firm with other elements of the international standard on quality control (ISQC) 1 and give recommendations to improve the compliance of quality control standard of public accounting firm X (PAF X) to ISQC 1. The research method used in this paper is a mixed method combining both survey and case study. The results of the survey were analyzed using square equation modeling (SEM) to test relationship among elements of ISQC 1. For the case study, current quality control standards of PAF X were compared to ISQC 1 for gap analysis. The result survey implies that leadership responsibilities for quality within the firm have a positive relationship with compliance to the relevant ethical requirements. Compliance to the relevant ethical requirements has a positive relationship with other elements of ISQC 1 excluding human resources. The results of the case study approach include recommendations to PAF X to modify quality control policies and procedures by adding policies, procedures, and attachments for elements of PAF X quality control standard. Modified quality control standards of PAF X should be communicated to all personnel at PAF X. Policies and procedures regarding human resources must be emphasized since compliance with the relevant ethical requirements fails to encourage compliance to human resources policies and procedures.

Keywords—policies; procedure; control; quality; standard

I. INTRODUCTION

Based on the Regulation of the Minister of Finance for the Republic of Indonesia, No. 17/PMK.01/2008, which relates to public accountant services, it is mandatory for Public Accounting Firms (PAFs) to use quality control standards that comply to the Professional Standard of Public Accountant and must cover all elements of quality control. There are six elements of quality control based on ISQC 1 that are: leadership responsibilities for quality within the firm; relevant ethical requirements; acceptance and continuance of client relationships and specific engagements; human resources; engagement performance; and monitoring. In Indonesia, the Indonesia Public Accountant Association (IAP) published SPM 1, which has been adopted from ISQC 1. In Indonesia, a quality review conducted by the IAP for 40 PAFs, during the period 2013–2016, resulted in finding of the noncompliance to SPM 1 [1]. The inspection report published by PCAOB reports that two-thirds of them revealed that International PAFs have a flaw in their quality control, except for PAFs affiliated with the Big Four [2].

Compliance to ISQC 1 is essential in maintaining public confidence in the service of the PAFs. The public entrusts PAFs to provide credible information, which is defined as information that is free from material misstatements, has faithful representation, and reflects events and transactions of a company's real performance [3]. Prior research conducted by Fauzi, Made, and Muhamad [4] revealed that a positive relationship exists between the implementation of ISQC 1 and audit planning effectiveness and audit quality. A quality review conducted by IAP had a positive relationship toward PAFs' ongoing concern [5]. Noncompliance to ISQC 1 that significantly influences independent auditors' reports may cause PAFs to lose their license as regulated in Article 40 Regulation of Minister of Finance of the Republic of Indonesia, No. 17/PMK.01/2008. Christiawan [6] stated that a PAF must provide sanction in case of an independence breach. A signed statement of independence may psychologically impact the audit personnel inferring that they may be punished for violation of independence.

The objectives of this research is as follows:

- To engage in a positive relationship of leadership responsibility for quality within the firm with compliance to relevant ethical requirements.
- To engage in a relationship of compliance to relevant ethical requirements with client acceptance and continuance.
- To engage in a relationship of compliance to relevant ethical requirements with human resources.
- To engage in a relationship of compliance to relevant ethical requirements with engagement performance.
- To engage in a relationship of compliance to relevant ethical requirements with monitoring.
- To engage in a compliance of the current policies and procedures of PAF X with ISQC 1 for audit engagement.
- To provide recommendations for increasing quality in delivering audit services within PAF X.

This research was conducted at PAF X, a middle-sized PAF in Indonesia. PAF X has certain problems regarding audit quality. These problems include frequent revisions of the final audit report, incomplete and messy audit documentation, and clients' disappointment toward auditors competence. Unlike prior research, this research aims to

understand the impact of leadership responsibilities for quality within the firm along with other elements of ISQC 1 in PAF X. Understanding this relationship will help researchers provide effective recommendations to improve the audit quality of PAF X. This research has developed five hypotheses to show this relationship. This research then performed a gap analysis of the current quality control policies and procedures with ISQC 1. Hence, this research can offer specific recommendations to modify the current quality control policies and procedures of PAF X, and thus increase compliance with ISQC 1.

This research differs from prior research because it uses the latest revision of ISQC 1, which was adopted in Indonesia and became effective on January 1, 2013, along with six elements of quality control instead of nine elements that was used by earlier researchers. This research also uses the mixed method (i.e., quantitative and qualitative approach) to analyze the data. Previous research did not use the mixed method with square equation modeling (SEM) analysis to offer recommendations by modifying the current quality control standards of PAF X. The quantitative approach uses SEM to analyze data. Compliance with SPM 1 will increase the reputation of PAF X. Therefore, using the service provided by PAF X to minimize agency costs may become a good indication to stakeholders of audited companies.

II. LITERATURE REVIEW

A. Theory of Attitude-Behavior Relationship

In the deliberative processing model suggested by Fazio [7], an individual considers their benefit before taking actions. This consideration in turn becomes planned behavior [8], which is behavior resulting from the deliberative processing model where a person has the motivation and opportunity (i.e., time and resources) to do something. Thus, auditors who work in an environment that emphasizes high quality will have positive values in mind that will determine their behavior while they work.

B. Agency Theory

Auditors are appointed to ensure that financial statements represent, in a fair manner, all material aspects based on Indonesia Financial Accounting Standards. Shareholders want to ensure that management (i.e., the agent) works in line with the shareholders' interest. Auditors are between management as the principal and management as the agent to reduce agency cost. Auditors must comply with Public Accountant Professional Standards (SPAP) while performing their duties. Since ISQC 1 is part of SPAP, compliance to ISQC1 will encourage auditors to issue high quality reports based on the real and factual condition of the company. In turn, this audit report will provide a positive indication to any external parties.

C. Signaling Theory

Signaling theory explains about a company that has the motivation to provide information to external parties. Positive signals will encourage investors to invest in the company because factual auditor diligence will assure any stakeholders that the information in any financial audit statement is credible. Therefore, compliance with ISQC 1 will give added value for PAF and increase the level of public confidence.

D. ISQC 1

Through the Minister of Finance Regulation Number 17/PMK.01/2008, the Minister of Finance gives authority to the Indonesia Institute of Public Accountant (IAPI) to use its authority based on Constitution Number 5, Year 2011. The Minister of Finance Regulation Number 17/PMK.01/2008 stated that it is mandatory for a PAF to have policies and procedures regarding quality control that fulfill SPAP and cover all elements of ISQC 1. The elements of ISQC 1 are as follows:

- Leadership responsibilities for quality within the firm;
- Relevant ethical requirements;
- Acceptance and continuance of client relationships and specific engagements;
- Human resources;
- Engagement and performance; and
- Monitoring.

Under ISQC 1, the objective of the company is to establish and maintain a system of quality financial control to provide it with reasonable assurance that:

- the company and its personnel comply with the professional standards and applicable legal and regulatory requirements; and
- reports issued by the company or engagement partners are appropriate in the circumstances.

III. HYPOTHESIS DEVELOPMENT

This research develops five hypotheses developed to understand the relationship between each element of ISQC 1. First, leadership responsibilities for quality within the company have a positive relationship to compliance of relevant ethical requirements (H_1). Banon et al (2010) stated that senior management involvement is a crucial determinant of ethical practice in an organization [9]. Research conducted by D'Aquila and Bean (2003) has shown that PAF personnel working in organizations with senior management that do not support ethical decisions tend to make unethical decisions [10]. In line with the Theory of Attitude-Behavior Relationship by Fazio [7], when an individual has motivation, opportunity, and cognitive capacity, their behavior results from a deliberative processing model.

Behavior of management toward quality forms perceptions in the minds of other personnel, and these personnel then tend to comply with relevant ethical requirements. Second, compliance to relevant ethical requirements has a positive relationship with continuance and acceptance of clients (H_2). Compliance to the relevant ethical requirements will encourage an in-depth analysis before accepting or continuing relationships with clients. Motivation from management and an opportunity to perform in-depth analysis will encourage personnel to behave in accordance with ethical requirements. Ethics is used when an individual makes a decision from some alternatives related to moral principle [11]. Therefore, commercial consideration in accepting or continuing relationships with clients does not ignore quality and work performance. Third, compliance to relevant ethical requirements has a positive relationship with human resources (H_3). A quality emphasized internal culture within PAFs will encourage development of the personnel's

competence so that personnel can provide a higher quality audit service. This statement is supported by Fazio [7] who suggested the Theory of Attitude-Behavior Relationship, "when people are sufficiently motivated to do so, they can

construct their attitude toward a task in a purposeful manner." Fourth, compliance to relevant ethical requirements has a positive relationship with engagement performance (H4).

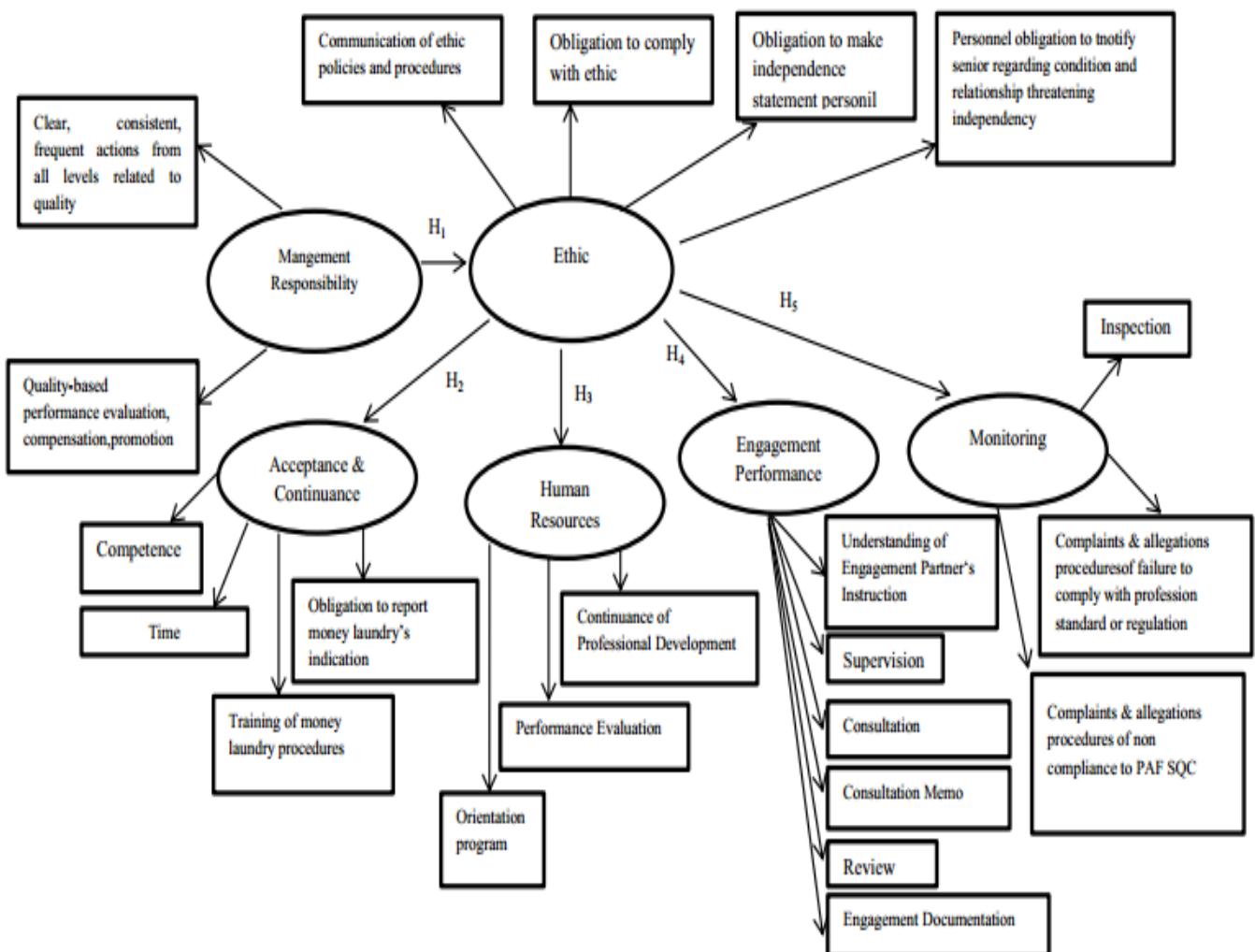


Fig. 1. Full Model Relationship of Management Responsibility for Quality Within Companies Toward ISQ1 Elements

Independency is one of the ethical requirements for an auditor. Auditors who comply with relevant ethical requirements will understand the essence of the statement of independency. Hurt et al (2013) stated that an auditor who is not independent might not perform an audit objectively within the appropriate professional skepticism. Independent auditors will improve the auditors' ability in assessment based on professional skepticism and maintain integrity and objectivity when identifying issues in audit engagement [12]. Fifth, compliance with the relevant ethical requirements have a positive relationship with monitoring (H5). Compliance with relevant ethical requirements to encourage effective monitoring due to objectivity and integrity. ISQC 1, paragraph 48, prohibits auditors who have engaged in selected audit engagement to perform inspection of that particular engagement. This result of monitoring will also not find any significant issue regarding compliance to the relevant ethical requirements. The full model based on the developed hypothesis is presented in Fig. 1.

IV. RESEARCH METHODS

PAF X as a unit of analysis within this research is problematic. PAF X is a medium-sized public accounting

firm in Indonesia. First, most of its audit engagements do not possess documentation as stated in the current policies and procedures of quality control standards of PAF X, like Client Acceptance and Continuance Forms, Independence Statements or a Confidentiality Statement. This documentation problem is caused by the nonexistence of policies and procedures regarding audit documentation of PAF X's quality control standards. There are no access restrictions or index for audit documentation. Second, there is no monitoring of the audit personnel's competence to meet quality control standards of PAF X because training is not integrated. Each partner decides which personnel is in need of training, the type of suitable training and the training budget, consequently competency among audit personnel differs significantly. Third, most audit reports are not reviewed by an engagement quality control reviewer prior to release except for high-risk clients. Fourth, the lack of resources at the engagement reviewer level limits monitoring activities. The quality control partner of the firm has no subordinates to conduct monitoring activities or conduct a review before the audit report is released. PAF X also does not have any policies and procedures to outsource the monitoring function. Fig. 2 displays the organization chart of PAF X:

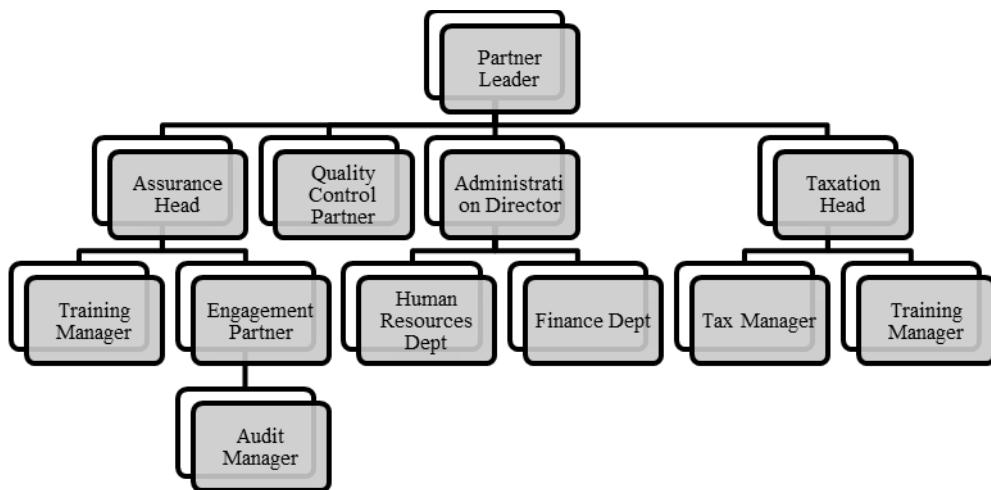


Fig. 2. Organization Chart of PAF X

Based on the monitoring schedule conducted in 2017, inspections were conducted for one day per selected engagement. Some partners reviewed two engagements per day. This finding is based on the analysis of the inspection schedule. The inspection was scheduled on August 21–25, 2017 for 14 audit engagements. Inspection teams comprised eight partners, including the quality control partner, who had no prior involvement in any of the audit engagements. Each engagement partner chose their own engagements to be inspected.

This research used the mixed method data collection and data analysis method. The data collected is primary data gained from the survey method. For the quantitative approach, researchers used questionnaires with the Likert Scale (1 = Strongly Disagree, 2 = Disagree, 3 = Neutral, 4 = Agree, 5 = Strongly Agree). Personnel used in this research were auditors with positions starting from junior to manager comprising 161 personnel. This group were selected because they were involved directly in audit engagement projects. Sampling methods used in this research are stratified random sampling to ensure all personnel involved in the audit engagement are selected. Table I displays the sample selected for each strata.

Data was analyzed using descriptive analysis and model analysis using Weighted Least Square (WLS) to test the hypotheses developed. Latent variables are six elements of quality control while the manifest of variables includes compliance indicators summarized by researchers based on ISQC 1. Table II shows the variables in this research.

The descriptive analysis used SPSS Software Version 22, while the SEM analysis uses AMOS Software Version 18. The Structural Model from this research is as follows (Figure 3).

Therefore, the SEM of this research is as follows: To perform the gap analysis and give effective recommendations to modify the current policies and procedures of quality control standards of PAF X, researchers used the qualitative approach. For the qualitative approach, researchers compared ISQC 1 with the PAF X's current policies and procedures of quality control standards based on IFAC 2010 guidance [13], *Tips for Cost Effective ISQC 1* and implementation guidance published by IFAC [14], *Guide to Quality Control for Small- and Medium-Sized Practices*.

TABLE I. SAMPLE

Position	Population	Sampling Proportion	Total Sample
Junior	83	61%	51
Semi Senior	16	61%	10
Senior	32	61%	20
Supervisor	11	61%	7
Assistant Manager	8	61%	5
Manager	11	61%	7
	161		100

TABLE II. LATENT AND MANIFEST VARIABLES

Latent Variables	Manifest Variables	Symbol
Management Responsibility (ξ_1)	Clear, consistent, and frequent actions from all levels related to quality	X1.1
	Performance, compensation, and promotion evaluation based on quality	X1.2
Ethic (η_1)	Communication of ethic policies and procedures	X2.1
	Obligation to comply with ethic	X2.2
	Obligation to make independence statement for each personnel	X2.3
	Personnel obligation to notify senior regarding condition and relationship threatening independency	X2.4
Acceptance and Continuance (η_2)	Competence	X3.1
	Time availability	X3.2
	Training for money laundry procedures	X3.3
	Obligation to report any indication of money laundering	X3.4
HR (η_3)	Orientation Program	X4.1
	Performance Evaluation	X4.2
	Continuance of Professional Development	X4.3
Engagement Performance (η_4)	Understanding of Engagement Partner's Instruction	X5.1
	Supervision	X5.2
	Consultation	X5.3
	Consultation Memo	X5.4
	Review	X5.5
	Engagement Documentation	X5.6
Monitoring (η_5)	Inspection	X6.1
	Complaints and allegations procedures of failure to comply with the professional standard or regulation	X6.2
	Complaints and allegations procedures of non compliance to PAF SQC	X6.3

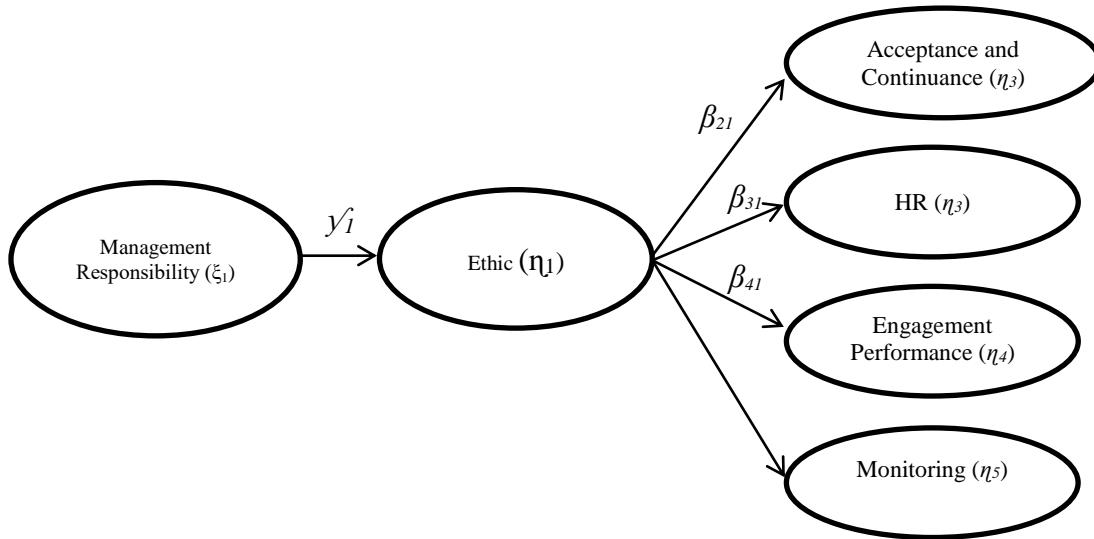


Fig. 3. Structural Model

V. RESULTS

A. Hypotheses Testing

On the basis of the data collected through questionnaires, the respondents included 52% men and 48% women. Only 26% of the respondents possess certification while the rest (74%) do not have professional certification and do not fulfill the competency credits set by PAF X.

Based on the skewed effect, the full model met normality because the data distribution was normally distributed. The results of Goodness-of-Fit Index shows that this data has met the Cut of Value as follows:

$$\text{Ethic } (\eta_1) = y_1 \text{ Management Responsibility } (\xi_1) + \delta$$

$$\text{Acceptance and Continuance } (\eta_2) = \beta_{21} \text{ Ethic } (\eta_1) + \delta$$

$$\text{HR } (\eta_3) = \beta_{31} \text{ Ethic } (\eta_1) + \delta$$

$$\text{Engagement Performance } (\eta_4) = \beta_{41} \text{ Ethic } (\eta_1) + \delta$$

$$\text{Monitoring } (\eta_5) = \beta_{51} \text{ Ethic } (\eta_1) + \delta$$

The model proposed in this research also fits with the data obtained with a significance level of 0,05 CR > 2 and $p < 0.05$ except for the relationship between ethic and human resources. Thus, the models proposed in this research are acceptable.

Based on the results in Table IV, H₁, H₂, H₄, and H₅ are acceptable because CR for each of these hypotheses is more than 2 (CR > 2) and p is less than 0,05 ($p < 0.05$). Management that encourages good internal culture positively increases compliance to ethics for PAF X personnel. This good internal culture encourages personnel to make decisions and behave as stated in the ethical requirements. In line with the research conducted by D'Aquila and Bean (2003) in Hansen et al. [10], PAF's management who always motivate and give opportunities to personnel by emphasizing quality will encourage each of the personnel to perform audits based on professional standards and the relevant ethical requirements. This result supports the Theory of Attitude-Behavior Relationship [7]. The second hypothesis (H₂) is acceptable. Personnel who comply with the relevant ethical requirements will perform an in-depth analysis before

accepting a new client or continuing engagements with current clients.

TABLE III. GOODNESS-OF-FIT INDICES UNTUK FULL MODEL

Goodness-of-Fit Indices	Cut of Value	Analysis Result	Model Evaluation
Chi Square	< 124.3	36,356	Good
Probability	> 0.05	0,056	Good
AGFI	> 0.90	0,939	Good
GFI	> 0.90	0,997	Good
TLI	> 0.95	0,984	Good
CFI	> 0.90	0,929	Good
RMSEA	< 0.08	0,107	Good

Commercial considerations should not be the main consideration for personnel who comply with the relevant ethical requirements and work in an environment where there is pressure from senior management. H₃ is rejected because CR is less than 2 (0.96) and p is more than 0.05 (0.365). Compliance to the relevant ethical requirements do not have a positive relationship with compliance to policies and the procedures regarding human resources. Cook and Kelly [15] stated that stress influences auditors to complete their tasks based on budget to achieve a satisfactory performance evaluation. An auditor who complies with these ethics but has a high work load that must be completed within time limitations along with limited resources may produce unsatisfactory reporting. Compliance to the relevant ethical requirements has a positive relationship with compliance to policies and procedures regarding engagement performance. Success of engagement performance depends heavily on independence. Auditors with no independence can result in audits not being performed objectively with appropriate professional skepticism. Auditors with the appropriate professional skepticism can evaluate sufficiency and appropriateness of the audit evidence, audit procedures, and detect fraud. Audit will be effective starting from planning, fieldwork until reporting and completion. The last hypothesis that is acceptable is H₅. Compliance to the relevant ethical requirements will maintain the objectivity of the person responsible for monitoring in PAF. By maintaining objectivity, individuals responsible for monitoring will perform effective monitoring. Effective monitoring helps to detect deficiencies and in communicating effective recommendations to eliminate deficiencies.

TABLE IV. REGRESSION WEIGHTS FULL MODEL

		<i>Estimate</i>	<i>S.E.</i>	<i>CR</i>	<i>P</i>	<i>Label</i>
Ethic	Management _ Responsibility	2,056	,789	2,607	,009	par_19
Acceptance and Continuance	Ethic	,728	,316	2,305	,021	par_20
HR	Ethic	,322	,355	,906	,365	par_21
Engagement_Performance	Ethic	,734	,336	2,187	,029	par_22
Monitoring	Ethic	1,855	,409	4,534	***	par_23
X1.2	Management _ Responsibility	1,000				
X1.1	Management _ Responsibility	1,611	,686	2,346	,019	par_1
X2.1	Ethic	1,000				
X2.2	Ethic	1,086	,287	3,778	***	par_2
X2.3	Ethic	,945	,289	3,270	,001	par_3
X2.4	Ethic	1,157	,313	3,695	***	par_4
X3.4	Acceptance and Continuance	1,000				
X3.3	Acceptance and Continuance	1,844	,806	2,288	,022	par_5
X3.2	Acceptance and Continuance	1,738	,759	2,289	,022	par_6
X3.1	Acceptance and Continuance	1,746	,730	2,392	,017	par_7
X4.3	HR	1,000				
X4.2	HR	1,817	2,131	,853	,394	par_8
X4.1	HR	3,639	3,995	,911	,362	par_9
X5.8	Engagement_Performance	1,000				
X5.7	Engagement_Performance	,309	,478	,647	,518	par_12
X5.6	Engagement_Performance	,985	,579	1,700	,089	par_13
X5.5	Engagement_Performance	1,831	,814	2,250	,024	par_14
X5.4	Engagement_Performance	-,106	,426	-,249	,804	par_15
X5.3	Engagement_Performance	,798	,405	1,971	,049	par_16
X5.2	Engagement_Performance	,629	,350	1,796	,073	par_17
X5.1	Engagement_Performance	1,212	,545	2,224	,026	par_18
X6.1	Monitoring	1,000				
X6.2	Monitoring	,764	,137	5,579	***	Par_10
X6.3	Monitoring	,895	,127	7,041	***	Par_11

The Validity and Reliability Test also shows that the questionnaire used in this research has valid questions and that the data obtained through the questionnaire can be relied upon. Below are Table V and Table VI showing the results of the Validity and Reliability Test.

B. Compliance of Current PAF X's Quality Control Standards with ISQC 1

1) Leadership Responsibilities for Quality Within the Company:

In Fig. 2, the Organization Structure of PAF X shows that the quality control partner has delegation from PAF X's Leader for operational responsibility of PAF X's quality control. The quality control partner is assisted by the Head of Administration who is responsible for human resources. ISQC 1 requires PAF to assign the responsibility of quality control to a person with sufficient and appropriate experience to enable that person to identify and understand quality control issues and develop the appropriate policies and procedures. ISQC 1 requires that an internal culture for quality be implemented as a basis for performance evaluation. PAF X already has a Performance Evaluation Form, however it currently has no conclusion over performance. PAF X does not have a performance rating scale. This condition may discourage personnel to maintain a higher quality of audit work. In this Performance Evaluation Form, personnel may set a target between six and 12 months,

TABLE V. VALIDITY TEST

Variables	Question	r table	r	Description
Management Responsibility	X1.1	0,200	0,398	Valid
	X1.2	0,200	0,398	Valid
Ethic	X2.1	0,200	0,416	Valid
	X2.2	0,200	0,468	Valid
	X2.3	0,200	0,477	Valid
	X2.4	0,200	0,538	Valid
Acceptance and Continuance	X3.1	0,200	0,427	Valid
	X3.2	0,200	0,323	Valid
	X3.3	0,200	0,406	Valid
	X3.4	0,200	0,405	Valid
HR	X4.1	0,200	0,433	Valid
	X4.2	0,200	0,399	Valid
	X4.3	0,200	0,245	Valid
Engagement Performance	X5.1	0,200	0,249	Valid
	X5.2	0,200	0,248	Valid
	X5.3	0,200	0,456	Valid
	X5.4	0,200	0,239	Valid
	X5.5	0,200	0,216	Valid
	X5.6	0,200	0,211	Valid
	X5.7	0,200	0,294	Valid
	X5.8	0,200	0,412	Valid
Monitoring	X6.1	0,200	0,572	Valid
	X6.2	0,200	0,635	Valid
	X6.3	0,200	0,811	Valid

but the performance evaluation is only conducted once a year. Overall, the policies and procedures of PAF X

regarding leadership responsibilities has complied with ISQC 1. However, some recommendations are needed to update the current policies and procedures

Testing of Structural Model Fit using AMOS Version 18 has the same model as proposed in Figure 3. The SEM Full Model analysis is as follows (see Figure 4).

2) Relevant Ethical Requirements:

The policies and procedures of PAF X regarding the relevant ethical requirements have not complied with ISQC 1. After comparing the current PAF X's quality control standards with ISQC 1, there is no criteria to determine the need to reduce the familiarity threat from senior personnel to an acceptable level. The policies and procedures to reduce familiarity threats is a rotation of engagement partner. This rotation is controlled by PAF X using the Client Rotation Form. In searching for interests of conflict when receiving tender invitations, PAF X only uses email to notify other partners. This method is ineffective for conflict checking since this information cannot be assessed on a real time basis. Another principle of accounting ethic besides independency is confidentiality. PAF X only requires each of its personnel to sign an independence statement. There is no declaration of confidentiality signed even during the recruitment process.

3) Acceptance and Continuance of Client Relationships and Specific Engagements:

Policies and procedures of PAF X regarding acceptance and continuance of client relationships have not complied with ISQC 1. The Client Acceptance Form of PAF X only provides general guidance in accepting new clients. The form does not have a detailed list of consideration to evaluate management integrity, communication with previous auditors, review of previous financial statements, expertise,

independence evaluation, threat identification, independency safeguard, and engagement risk assessments. Both the Client Acceptance Form and Client Continuance Form do not contain a client's risk classification. *Guide to Quality Control for Small- and Medium-Sized Practices* [14], a questionnaire must be used so there is a consistent consideration before accepting or continuing a relationship with a client. Researchers inspected 20 audit engagements and found that most did not have the Client Acceptance Form and the Client Continuance Form as stated in PAF X's quality control standards. This means that personnel of PAF X do not comply with PAF X's policies and procedures regarding client acceptance and continuance.

4) Human Resources:

The policies and procedures of PAF X regarding human resources do not comply with ISQC 1. PAF X already has set a minimum number of credits that is a requirement for the continuance of professional development for each level, they are as follows: partner (40 credits), manager (30 credits), supervisor (20 credits), senior (20 credits), and junior (20 credits).

TABLE VI. RELIABILITY TEST

Questions	Alpha Cronbach	Description
Management Responsibility for quality within firm	0,640	Reliable
Compliance to ethic	0,690	Reliable
Acceptance and Continuance with client	0,606	Reliable
Human Resources	0,634	Reliable
Engagement Performance	0,638	Reliable
Monitoring	0,816	Reliable

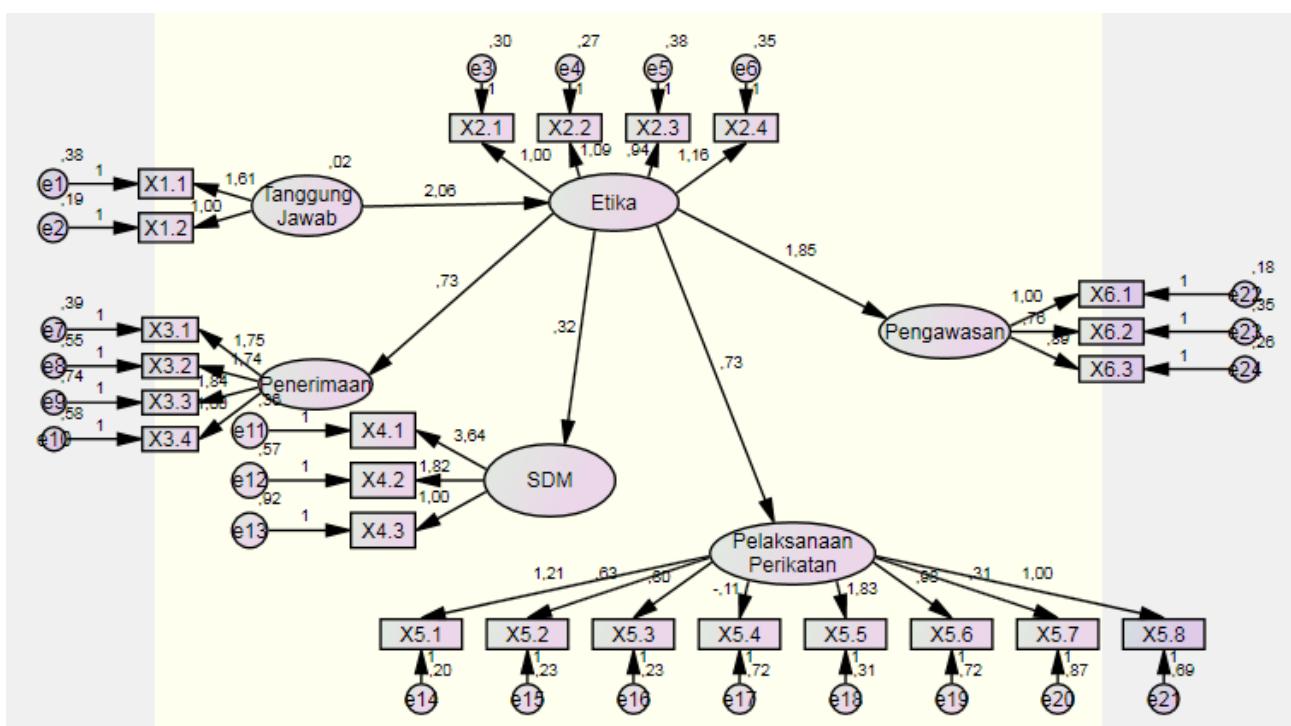


Fig. 4. Analysis of SEM Full Model

However, based on the data gathered through the questionnaires, PAF X's personnel, from junior level to Assistant Manager, have not fulfilled this requirement. PAF X does not have a policy and procedure for its personnel to report credits earned annually. Therefore, there is no enforcement and sanction for this requirement. The next problem is that there is no frequent centralized training in the headquarters; however, the Form of Continuance of Professional Development Plan had been made available to each partner. Each partner has the authority to determine which training will be available for joining and who will join. This condition causes the competence of personnel in each of PAF X's branches to differ. Among the respondents, 7.29% stated that they did not have an orientation program. Decentralized recruitment is the root cause of this problem. Last, the Notes of Audit Team Assignment is used for engagement partners to assign an audit team. In the Notes of Audit Team Assignment, only previous experiences become a consideration for assigning personnel to a task. However, ISQC 1 requires a consideration of technical skills, understanding of the clients industry, an understanding of the relevant professional standard, adherence to the law and regulations that are in place, an ability to use professional judgment, and the understanding of policies and procedures of PAF X's quality control before assigning any audit personnel.

5) Engagement Performance:

Policies and procedures of PAF X regarding engagement performance have not complied with ISQC 1. PAF X does not have policies and procedures regarding the use of qualified professional outside the company as required by ISQC 1. PAF X also does not have any criteria for the appointment of qualified professionals outside the company. These policies and procedures are necessary since the quality control partner has no team to support engagement quality and control a review in PAF X based on the organizational chart. PAF X also does not have policies and procedures regarding deadlines for documenting a final working paper including audit evidence after the reporting date. PAF X does not have policies and procedures regarding confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation.

6) Monitoring:

Policies and procedures of PAF X regarding monitoring have not complied with ISQC 1. The monitoring process is performed on two levels; they are monitoring for process and the main procedures of quality and monitoring of implementation of PAF X's policies and procedures for each engagement. Based on the current PAF X's quality control standards, the results of the monitoring will be communicated to the Head of Assurance and the Head of the Taxation Department but not the Head of Administration and Finance. In fact, the Head of Administration and Finance is responsible for the quality of human resources in PAF X. In addition, PAF X does not have any policies and procedures regarding the use of qualified professionals outside the company that are involved in the monitoring process. There is no criteria set for serious disciplinary action for deficiencies in the monitoring process.

PAF X must add a monitoring process by assessment for some matters as stated in the *Guide to Quality Control for Small- and Medium-Sized Practices* [14]. Those matters are the inspection process; nature, timing, and effectivity of

policies and procedures of PAF X in communicating complaints and allegations; sufficiency of technical material such as references, appropriateness of policies, and procedures toward profession development.

C. Recommendation to Modify Current PAF X's Quality Control Standards

Based on the compliance analysis, below are the recommendation to modify the current PAF X's quality control standards:

1) Leadership Responsibilities for Quality Within the Company:

- Add explanations regarding the competency and experience of the quality control partner.
- Set a performance rating scale and with a conclusion of performance evaluation in the Performance Evaluation Form.
- Adjust performance targets set in the Performance Evaluation Form with frequency of performance evaluation. Six-month targets must be followed by at least twice-a-year performance evaluation.

2) Relevant Ethical Requirements:

- Set criteria to reduce any familiarity threat for senior personnel like reviewing engagement partners or senior personnel who have a significant role, changing the role of senior personnel.
- Produce a database with client information including the related parties that can be accessed by all PAF X's personnel.
- Use a declaration of confidentiality at the time of personnel recruitment. This declaration should be signed by each personnel annually as a reminder.

3) Acceptance and Continuance of Client Relationships and Specific Engagements:

- Replace the Client Acceptance Form of PAF X with a Client Acceptance Questionnaire as in *Appendix C—Guide to Quality Control for Small- and Medium-Sized Practices* [14].
- Documenting the consideration of client continuance evaluation in the Supporting Form of Client Continuance Evaluation List. This form has been modified by researchers from what was the Client Continuance Form of PAF X.
- Add two considerations in the Client Continuance Form. These considerations are a fulfillment of rotation requirement and a risk classification of prospective clients. These considerations will ensure that PAF X has complied with the relevant ethical requirements and considers any engagement-related risks before continuing engagement with current clients.
- Add new procedures stating that the quality control partner must review Client Acceptance Questionnaires or Client Continuance Forms of PAF X SPM KAP X as illustrated in *Appendix C—Client Acceptance* [14]. By doing so the engagement partner will have no reason for not documenting the Client Acceptance Questionnaire or the Client Continuance Form for each engagement.

4) Human Resources:

- Add policies and procedures so that each personnel is required to report total credits of continuing professional development that is earned annually. This report must be supported by the official training certificate from the accountant association. By doing so, the human resource department may control personnel who have not met PAF X competency requirements.
- Centralize recruitment in PAF X's headquarter in Jakarta so that a personnel database can be updated regularly. Every new recruit will be part of an orientation program.
- The Administration and Finance Head must communicate with the Head of Assurance Department to plan integrated training based on the needs identified in the Form of Continuance Professional Development Plan drawn up by each partner based on performance evaluations.
- Based on the *Guide to Quality Control for Small- and Medium-Sized Practices* [14], it is recommended that an additional responsibility be given to the Head of Administration who is responsible for the quality of human resources. The responsibilities are as follows:
 - a. Control and ensure compliance toward policies and procedures of PAF X regarding human resources by maintaining Independence Statements, Declaration of Confidentiality, and Continuance Professional Development Plans.
 - b. Ensure each new personnel joins an orientation program and develops orientation material.
 - c. Maintain a continuing professional development plan based on the Form of Continuance Professional Development Plan made by each partner.
 - d. Give rewards or punishments to personnel for compliance to PAF X's quality control standards. These rewards may be supported by adding inspection results as consideration for performance evaluation and promotion.
- Add some consideration besides experience in the Notes of Audit Team Assignment like technical skills, understanding of the client's industry, understanding of professional standards, laws and regulations, ability to use professional judgment, and understanding of policies and procedures of PAF X's quality control.
- PAF X must have policies and procedures regarding any disciplinary act. The policies and procedures must encourage problem solving using steps based on the *Guide to Quality Control for Small- and Medium-Sized Practices* [14] like:
 - a. Interview personnel involved to gather facts and discuss the root cause including the solution.
 - b. Perform counseling or mentoring.
 - c. Scheduling another interview to ensure compliance and remind personnel to take remedial action by oral or written warning,

written notes in personnel performance record, requirements to meet any continuing professional development program, formal notification to accountant association, or curtailment.

- Each partner must maintain a schedule of resources he/she has to assist in consideration of time availability and resources before accepting any new audit engagement.

5) Engagement Performance:

- PAF X must set policies and procedures regarding the use of qualified professionals outside the company. The policies and procedures must cover the following:
 - a. Confirmation of competence, experience, independency, and confidentiality of any third party.
 - b. Compliance to relevant any ethical requirements, especially independence and confidentiality.
 - c. All Third parties must be given the relevant facts that enable them to make appropriate suggestions.
 - d. Any condition that may cause the need of third-party assistance for consultation and then an engagement quality control review must be documented.
 - e. The conclusion from any third party must be documented to enable the reader, who was not involved in the engagement, to understand the nature of any conclusions and recommendations of the third party.
 - f. In case a conclusion is not implemented or is implemented differently from the conclusion made, the engagement partner must document any reasons and considerations for such actions.
 - PAF X must set criteria for appointment of qualified professionals outside the company. The criteria can be found in the *Guide to Quality Control for Small- and Medium-Sized Practices* [14].
 - PAF X must set policies and procedures regarding any timelines for completing the final working paper after the reporting date. It is recommended that PAF X to set a deadline of 60 days after the reporting date and all working papers must be archived. Any changes after the deadline, must be informed to the person in charge.
 - PAF X must set policies and procedures regarding confidentiality, safe custody, integrity, accessibility, and retrievability of any engagement documentation.
- 6) Monitoring**
- PAF X must add a monitoring process along with monitoring for the process and main procedures of quality and monitoring of implementation PAF X's policies and procedures for each engagement. *Guide to Quality Control for Small- and Medium-Sized Practices* [14] stated that monitoring should be performed on an inspection process; nature, timing, and effectiveness of policies and procedures of PAF X in communicating complaints and allegations; sufficiency of technical material such as references,

- appropriateness of policies and procedures toward professional development;
- PAF X must set policies and procedures regarding the use of qualified professionals outside the company to be involved in the monitoring process;
 - Results that are documented in the Monitoring Form must be communicated to the Head of Administration and Finance, the Head of Assurance, and the Head of Taxation Department;
 - PAF X must set criteria for serious disciplinary action toward deficiencies resulting from the monitoring process;
 - PAF X must modify the Monitoring Form by adding recommendations for disciplinary action and to modify deficiencies reporting in a descriptive explanation instead of points.

VI. CONCLUSION AND SUGGESTIONS

Based on the research, leadership responsibilities have a positive relationship with compliance to relevant ethical requirements. In addition, compliance to relevant ethical requirement has a positive relationship with client acceptance and continuance, engagement performance, and monitoring, except for human resources. By comparing current PAF X's quality control standards, research found that five of the six elements do not comply with ISQC 1. Urgent revision is needed to resolve these current problems. The revised PAF X's quality control standards must be communicated by PAF X's management because it will encourage compliance to relevant ethical requirements. Urgent revision must be undertaken especially for the setup of a performance rating scale and recommendations about relevant ethical requirements and human resources.

Limitations of this research are applied to audit engagement. This research does not consider other International Standards of Auditing related to ISQC 1 except for ISA 230 regarding audit documentation. The researchers suggest that future research should study the management of human resources in a public accounting company to increase the quality of services rendered. Human resources is an asset within public accounting companies that must be managed and monitored for the public accounting company's sustainability.

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