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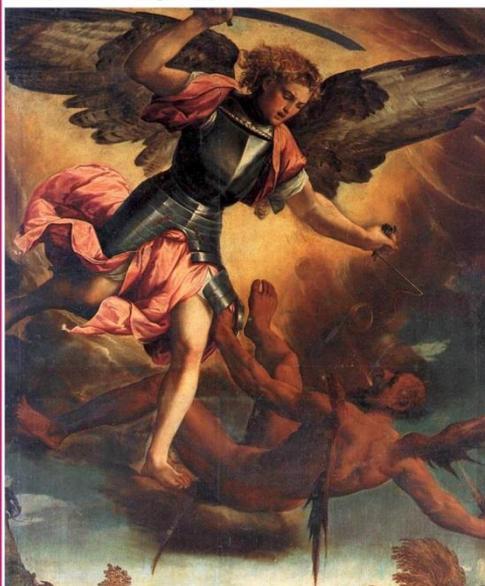
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# Does the Adoption of International Standards Affect Audit Quality?

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## Abstract

This study employs a descriptive method by using the survey research approach and uses the regression analysis to investigate the empirical data. Independent variable of this research is the implementation of auditing standards that emphasized on ISAs, while the dependent variable is audit quality based on quality indicators around balanced scorecard with four categories: inputs, process, outcomes, and context. The result showed that the implementation of auditing standards based on ISAs has a significant influence on audit quality. Also, the audit firm's audit quality is already well, but the ISAs provide the legal force to reduce standards violation.

**Keyword:** audit firm, audit quality, International Standards on Auditing

## *?La adopción de normas internacionales afecta la calidad de auditoría*

### **Resumen**

Este estudio emplea un método descriptivo utilizando el enfoque de investigación de la encuesta y utiliza el análisis de regresión para investigar los datos empíricos. La variable independiente de esta investigación es la implementación de estándares de auditoría que enfatizan las ISA, mientras que la variable dependiente es la calidad de la auditoría basada en indicadores de calidad en torno al cuadro de mando integral con cuatro categorías: entradas, proceso, resultados y contexto. El resultado mostró que la implementación de estándares de auditoría basados en ISAs tiene una influencia significativa en la calidad de la auditoría. También la calidad de la auditoría de la firma de auditoría ya está bien, pero las NIA proporcionan la fuerza legal para reducir la violación de los estándares.

**Palabra clave:** firma de auditoría, calidad de auditoría, Normas Internacionales de Auditoría

### **1. INTRODUCTION**

Doubts over public accounting profession keep increasing due to the numerous cases of financial report manipulation involving several audit firms included in the big five such as Arthur Andersen, PWC, E & Y, Deloitte and KPMG in 2000-2003. People lost even more trust in financial report preparation and examination systems. Wall Street also questioned the availability of auditors over the fraud scandal unfolding that year (Hegarty et al., 2004).

Credibility of an auditor in maintaining the audit quality is also doubted considering numerous administrative sanctions over public accountants and audit firms in Indonesia for not fulfilling their obligation to obey the laws regarding public accountants, which include: maintaining competence through continuous professional training; behaving well, honestly, responsibly and possessing high integrity; obeying and performing audit firms professional standards; and reporting the activities, audit firm's financial report and yearly program implementation report for foreign workers to the Minister. Administrative sanctions may take form as a recommendation to do certain obligations, written warning, limitation of service providing towards certain entity, limitation of providing certain services, permit freezing, permit revocation, and/or fines (Etcuban & Pantinople, 2018).

Administrative sanctions over audit firms in 2014 were caused by a violation related to the delay in business activities report presentation and the weakness of audit firms' quality control system application based on the examination results. From the two tables above, it could be seen that there are still a lot of violations committed by either public accountants or audit firms over their obligations in obeying the laws on Public Accounting, but the data does not represent low audit quality since the total sanction issued relatively insignificant when compared to the total of all audit firms and public accountants in Indonesia. Besides that, from the total of 134 violations by public

accountants, there were only 10 cases of technical violation (violations related to the application of SPAP).

One of the efforts to improve audit quality in Indonesia is through the adoption of the latest risk-based audit standards referring to the International Standards on Auditing (ISA) by the IAPI. One of KPMG's partners, Thong Foo Vung, said that the purpose of ISA is to develop a standard that is easy to comprehend, clear, and able to be applied consistently so it can give higher assurance level in regards to the uniformity of practice worldwide.

International Standards on Auditing (ISA) is one of the audit standards issued by the International Auditing and Assurance Standards Board (IAASB, 2013). The purpose is to achieve uniformity in quality financial reporting standards on a global basis. ISA has been a current global phenomenon since a lot of countries have started to adopt said international-based audit standards.

Indonesian Institute of Certified Public Accountant (IAPI) has decided to adopt the ISA for financial report auditing process in Indonesia. ISA started to be applied by public accountants in performing audit over financial reports for the period starting on or after January 1<sup>st</sup>, 2013. The adoption of ISA in Indonesia is one of the efforts to fulfil the obligations stated in the Statements of Membership Obligations (SMO) as one of IFAC members. Indonesia's membership in IFAC is currently represented by the Ikatan Akuntan Indonesia (IAI), while IAPI is still in the submission process to become an IFAC member. After the implementation of ISA, it is hoped that the trust of global investors in the quality of financial information in Indonesia

would increase. This is a good opportunity for Indonesia as one of the G20 countries. The final G20 meeting in Washington, D.C. in November 2008 showed the result that G20 countries represented 85% of the world economy.

Before ISA was adopted in Indonesia, Public Accountant Professional Standards (SPAP) referred to the audit standards in the United States, which is the Generally Accepted Auditing Standards (GAAS). SPAP divides auditing standards into three main parts, including the General Standards, Field Work Standards, and Reporting Standards. In ISA, there is no such categorizing as found in SPAP. Aside from that, there are several other differences, which are substantial and fundamental, between ISA and the previous audit standards, including (1) the emphasis in risk-based audit, (2) the change from rule-based standards to principle-based standards, (3) the elimination of mathematical approach in audit practice, (4) the emphasis in professional judgement, (5) the evaluation and internal control reporting over financial report, and (6) the inclusion of Those Charged With Governance (TCWG) under supervision of an entity. These differences would affect the change in an auditor's way of thinking underlying certain audit techniques.

A lot of pros and contras regarding benefits and costs cause the implementation of ISA in Indonesia to undergo a long and time-consuming process. This phenomenon cannot be separated from the fact that there would be an increase in cost spent by audit firms such as the cost of education and training, publication of new audit guidelines,

and under ISA's terms, there would be more time for partners to participate in the engagement.

According to Izma (2011), the purpose of clarified ISA is to improve the audit quality in order to achieve convergence with global standards, but the implementation would be a challenge for some parties. Several areas of problems emerge as a concern in discussion forum regarding the implementation of ISA, especially for small and medium practitioners (SMPs). The big four audit firms usually receive periodical training from the head office. Thus the information about international standards will be easier to access and continuously updated.

According to Elfarini (2007) in Ramdanialsyah (2010), high level of trust from the users of audited financial reports and other services provided by public accountant eventually urges public accountant to pay attention to the quality of audit performed. Audit quality is important because, with high-quality audit, a trusted financial report can be produced as the basis for decision-making.

Therefore, the latest description of the effect of the implementation of risk-based audit standards in audit firms listed at Otoritas Jasa Keuangan (OJK) across Indonesia becomes very important to be studied further.

## **2. LITERATURE STUDY AND HYPOTHESIS DEVELOPMENT**

### **Auditing and Auditing Standards**

According to the Committee of Auditing Concepts, auditing is a systemic process to obtain and objectively evaluate the evidence on a statement regarding economic activities or events to improve the level of conformity of the statement to determined criterias, as well as to communicate its results to the stakeholders. The users of financial reports hope for the auditor to find and detect any fraud. Fraud itself is quite a broad concept. SAS No. 82 regarding Consideration of Fraud in a Financial Statement Audit (AU 316) states that a specific interest of an auditor relates to the act of fraud causing the materials to be misrepresented in the financial report. Audit standards are crucial in creating an audit with excellent quality. Arens et al. (2012) argued that auditing standards are the guidelines for auditor in performing their professional responsibilities. Auditing standards are made in accordance with basic concepts.

These concepts are needed since they are the basis of standards creation serving the purpose of directing and measuring the quality from which audit procedures may derive. Professional standards are technical standards aiming to regulate the quality of services provided by the public accountant profession in Indonesia. The adoption of ISA was done by revisioning the Audit Firms Professional Standards (SPAP) which had been used as a reference for public accountant in providing their services to the public. DSPAP IAPI has held various public hearing and socialization regarding the latest, valid audit standards since 2012.

The structure of ISA-based auditing standards consists of introduction, purpose, definition, and terms. An auditor has to obey all auditing standards relevant to the audit. ISA obliges its auditors to have an understanding of the whole contents of an auditing standard, including other materials and explanations. Auditors cannot state their obedience towards auditing standards in auditor reports when they do not obey the terms of AS 200 and other relevant auditing standards (Tuanakotta, 2013; Pineno & Gelikanova, 2010; Naghi Nahrsulduz, 2017).

### **ISA-Based Audit Engagement Standards**

The adoption of ISA is committed through some revisions to the Public Accountant Professional Standards that had been used as a reference for Public Accountants in providing their services (Yang et al., 2019; Soo et al., 2019).

## **3. RESEARCH METHOD**

### **Research Variables and Variable Operationalization**

As a novel strategy in this research, the variables and their operationalization studied as the basis in creating a research questionnaire are as follows:

1. Independent Variable (X): The independent variable is the Implementation of Auditing Standards based on the International Standards on Auditing (ISA). This variable is described in the form of

indicator considered to be representing the availability of related variable, which is the Audit Engagement Standards. All statement items are measured on a Likert scale.

2. Dependent Variable (Y): The dependent variable is Audit Quality. The indicators of audit quality in the questionnaire are taken from the indicators developed by Knechel et al. (2012). All statement items are measured on a Likert scale. The operationalization of variables used can be seen on the following table:

Variable	Dimension	Indicator	Scale
<p>INDEPENDENT VARIABLES</p> <p>Implementation of Auditing Standards based on the International Standards on Auditing (ISA) (X)</p> <p>Source: aicpa.org/FRC</p>	<p>Specific Audit Standards emphasized in ISA-based SA</p>	SA 200	Ordinal
		SA 210	
		SA 220	
		SA 230	
		SA 260	
		SA 510	
		SA 560	
		SA 570	
		SA 580	
		SA 600	
		SA 620	
		SA 700	
		SA 705	
		SA 710	
SA 720			
SA 800			

		SA 805	
		SA 810	
<p style="text-align: center;"><b>DEPENDENT VARIABLE</b></p> <p style="text-align: center;">Audit Quality (Y)</p> <p style="text-align: center;">Source: Knechel et al. (2012)</p>	Input	Incentives and Motivation	Ordinal
		Professional Skepticism	
		Knowledge and Expertise	
		Within-firm Pressures	
	Process	Judgement in the Audit Process	Ordinal
		Audit Production	
		Assessing Risk	
		Analytical Procedure	
		Obtaining and Evaluating Audit Evidence	
		Auditor-Client Negotiations	

		Review and Quality Control	
	Outcomes	Adverse Outcomes	Ordinal
		Audit Reports	
		Regulatory Reviews of Audit Firms	

Table 1: Operationalization of Variables

**Population and Sample**

The target population in this research is auditors restricted to supervisor positions and partners of Audit Firms in three big cities in Indonesia. Sample determination technique in this research uses a convenience sampling technique. This method determines the sample from the elements of the population (people or events) of which data is easy to obtain. Convenience sampling is chosen because the sample cannot be determined by the number of respondents alone, but also by their willingness to fill in the questionnaire (Sugiyono, 2012; Babazadeh, 2017).

**Type and Source of Daata**

The data source used in this research is primary data. The research is performed by spreading the questionnaires directly to Audit Firms in three big cities in Indonesia.

### **Data Analysis Method**

Data collected in this research is processed, then analysed using statistic analysis including

- Validity test, to prove how far the data in the questionnaires could measure what should be measured, through Pearson's correlation coefficient, product moment.

- Reliability test, to verify how consistent a measurement instrument measured whatever concept it measures, by using Alfa Cronbach's formula, Sekaran (2006).

- Hypothesis test plan, to examine the level of significant whether an independent variable affects the dependent variable in the research. Zero hypotheses are the hypothesis implying that the independent variable does not affect the dependent variable. Meanwhile, an alternative hypothesis is the hypothesis implying that the independent variable has a significant effect on the dependent variable.

$H_0$  and  $H_a$  formulation in this research is as follows:

$H_0 : \rho \leq 0$  There is no positive effect of International-Based Audit Standards Implementation significant to Audit Quality.

$H_a : \rho \geq 0$  There is a positive effect of International-Based Audit Standards Implementation significant to Audit Quality.

- Data in this research uses the ordinal scale, so it needs to be converted into an interval scale using the interval method (method of the successive interval).

- Classic assumption test, consists of (1) data normality test, to verify whether, in a regression model, dependent and independent variables have normal data distribution; (2) heteroscedasticity test, to verify whether there is variant dissimilarity from one residual to other observation; (3) multicollinearity test, to see whether there is a high correlation between independent variables in a double linear regression model.

- The analysis used in this research is the double linear regression, to test the effect between independent variables and dependent variable.

- Hypothesis testing in this research is related to how far the effect of one variable towards other variables. The stage of hypothesis testing is by performing t test. The test is conducted using a significance level of 0.05 ( $\alpha=5\%$ ).

- Afterward, determination coefficient is calculated to measure how far the ability of the model to explain dependent variable's variations; also the level of significance determined to find conclusion in this research is at 0.05 ( $\alpha =5\%$ ) which means that the level of trust from conclusion drawing result has probability of 0.95 or tolerance of 0.05, then it can be concluded whether independent variables affect positively towards dependent variable.

#### **4. RESULT AND DISCUSSION**

Based on the test results, it can be inferred that the statement items in the questionnaire are valid and reliable. The result of t test calculation shows that  $H_a$  is accepted. Thus it can be concluded that the Implementation of International-Based Audit Standards significantly affects Audit Quality. From the simple linear regression equation test, we can see that there is a positive effect of the Implementation of International-Based Audit Standards towards Audit Quality. Furthermore, the result of determination coefficient test shows that the dimension of the influence of International-Based Audit Standards Implementation towards Audit Quality is at 17.3% while the influence of other variables unstudied in this research is at 82.7%.

The dimension of the influence of International-Based Audit Standards Implementation towards Audit Quality in Audit Firms shows that the value was not high enough, caused by the fact that Audit Firms in three big cities in Indonesia have performed their audit based on the valid standards. However, in regards to the latest phenomeneon, violation found in Audit Firms or Public Accountant over their obedience toward determined standards is still a concern for the supervisors, in this case, the Financial Department Profession Development Center. A regulation without adequate supervision may potentially turn into a useless one.

## **5. CONCLUSION**

Based on the hypothesis testing result, it can be concluded that International-Based Audit Standards Implementation has a significant effect on Audit Quality at the Audit Firms in three big cities in Indonesia. Data analysis result shows that the value of influence is not large enough to show any indication that the audit practice performed all this time is well enough, but the finding of violations in Audit Firms or Public Accountant over the obedience towards determined standards is an opportunity to develop a research on audit quality, especially regarding how large of an effect the supervising process implemented by supervising body has. The final result from this research is the description of supervising mechanism adequacy over determined standards, so the purpose of the standards can be achieved at the maximum level.

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