International Journal of Economics, Business and Accounting Research (IJEBAR)
Peer Reviewed – International Journal
Vol-7, Issue-3, 2023 (IJEBAR)
E-ISSN: 2614-1280 P-ISSN 2622-4771
https://jurnal.stie-aas.ac.id/index.php/IJEBAR

THE EFFECT OF AUDIT RISK ON AUDIT QUALITY THROUGH AUDIT FEES IN PUBLIC ACCOUNTING FIRM IN WEST JAKARTA

Dodik Jatmika[1], Muhammad Nurdin[2]
STIMI Banjarmasin[1,2]
Email: dodik_jatmika@yahoo.com[1], muhammadnurdin1986@gmail.com[2]

Abstract: This study aims to analyze (1) the effect of audit risk on audit fees in West Jakarta, (2) the effect of audit risk on audit quality in West Jakarta, (3) the effect of audit fees on audit quality in West Jakarta, and (4) the effect of audit risk on audit quality through audit fees in West Jakarta. This study uses a population of Public Accounting Firms (KAP) located in West Jakarta, totaling 107 KAP, with sampling based on the survey method. The results of the study indicate that: (1) audit risk has a positive effect on audit fees, (2) audit risk has a negative effect on audit quality, (3) audit fees have a positive effect on audit quality, and (4) audit risk has an effect on audit quality through audit fees in KAP West Jakarta.

***Keywords**: Audit Risk, Audit Fee, Audit Quality, Public Accounting Firm, West Jakarta.*

Submitted: 2023-08-08; Revised: 2023-09-07; Accepted: 2023-09-19

---

1. Introduction

Audit quality plays a pivotal role in ensuring the reliability of financial information used by various stakeholders, particularly investors. High-quality audits enable investors to make informed decisions and minimize the risk of financial misrepresentation. DeAngelo (1981) emphasizes that audit quality is influenced by the size of audit firms, with larger firms (Big 4) often perceived to deliver superior audit outcomes compared to smaller firms. However, the dynamics of audit quality are not solely dependent on firm size but are also influenced by factors such as audit fees and audit risks.

Audit fees, as noted by Iskak (1999), represent the remuneration charged by public accountants to clients for the auditing services provided. The determination of audit fees often depends on variables such as client size, the duration of the audit process, and the auditor's reputation. Recent studies, such as those by Kurniasih and Rohman (2014), suggest that audit fees have a significant positive impact on audit quality. This correlation implies that higher fees enable auditors to allocate more resources and time, thereby enhancing the thoroughness of the audit process.

Meanwhile, audit risk is another critical element affecting audit quality. According to Mulyadi (2014), audit risk arises when an auditor unknowingly fails to modify their opinion on financial statements containing material misstatements. Audit risk consists of three main components: inherent risk, control risk, and detection risk. These risks can influence the quality of audit procedures and outcomes. Coram et al. (2008) highlight the importance of mitigating audit risk to ensure the reliability of financial statements. The Indonesian auditing landscape faces unique challenges, particularly with the regulatory environment and the varying quality among audit firms. The issuance of regulations such as the Minister of Finance Regulation No. 17/PMK.01/2008 aims to enhance audit quality by stipulating guidelines for audit practices. However, achieving consistent audit quality remains a concern, especially among smaller firms.

This study focuses on exploring the interplay between audit risk, audit fees, and audit quality among public accounting firms in West Jakarta. While prior research has established foundational insights, the context-specific factors in Indonesia, such as regulatory frameworks and market dynamics, warrant further investigation. For example, Yuniarti (2011) identifies that audit fees significantly influence audit quality in Indonesia, with higher fees correlating to better quality due to increased resource allocation. However, the question of how audit risk interacts with audit fees to impact quality remains underexplored.

The research questions addressed in this study include: (1) How does audit risk influence audit fees in public accounting firms in West Jakarta? (2) How does audit risk affect audit quality? (3) What is the impact of audit fees on audit quality? and (4) Does audit risk indirectly influence audit quality through audit fees? By addressing these questions, this study aims to provide comprehensive insights into the determinants of audit quality, contributing to both academic literature and practical applications in the field of auditing.

In line with previous studies, such as those by Watkins et al. (2004), this research adopts a multi-variable approach to analyze the interrelationships among audit risk, audit fees, and audit quality. The findings are expected to provide actionable recommendations for public accounting firms in West Jakarta, enabling them to improve audit practices and outcomes.

The significance of this study lies in its ability to bridge gaps in the existing literature by focusing on an under-researched context. Moreover, by employing a robust methodological framework, this study seeks to deliver reliable and generalizable findings that can inform policy-making and professional practices in Indonesia's auditing sector. Ultimately, the study underscores the criticality of managing audit risk and optimizing audit fees to achieve higher audit quality, thereby strengthening public trust in financial reporting systems.

2. Literature Review

2.1. Audit Quality

Audit quality refers to the ability of an auditor to detect and report any material misstatements in financial statements, ensuring that the auditing process adheres to established standards. DeAngelo (1981) conceptualized audit quality as the probability that an auditor will both discover and report a breach in financial reporting. This probability is influenced by the auditor's technical competence and independence. The importance of audit quality has been reiterated in numerous studies, including those by Watkins, Hillison, and Morecroft (2004), who highlighted the role of auditor expertise and ethical considerations in ensuring reliable financial statements. Recent research, such as that by Alzeban and Sawan (2015), indicates that client pressure and reduced auditor independence negatively affect audit quality, emphasizing the need for strict regulatory oversight. Thus, audit quality plays a pivotal role in maintaining stakeholder confidence and ensuring market stability.

2.2. Audit Fee

Audit fees are the remuneration paid by a client to an auditor for their services. According to Iskak (1999), audit fees are influenced by factors such as the size of the auditee, the complexity of the audit, and the duration of the audit engagement. The relationship between audit fees and audit quality has been extensively studied, with results indicating that higher fees often correlate with better audit quality (Kurniasih & Rohman, 2014). This is because higher fees enable auditors to allocate more resources, conduct thorough assessments, and mitigate risks of errors or fraud. Additionally, recent findings by Habib (2019) suggest that audit fees are also shaped by market competition and the reputation of the auditing firm. Therefore, while audit fees are necessary for sustaining the auditing process, their determination must balance affordability for clients and the need for thorough and impartial audits.

2.3. Audit Risk

Audit risk is the likelihood that an auditor may issue an incorrect opinion on financial statements that contain material misstatements. According to Mulyadi (2014), audit risk consists of three components: inherent risk, control risk, and detection risk. Inherent risk refers to the susceptibility of financial statements to material misstatements before considering internal controls. Control risk is the probability that a company's internal controls fail to prevent or detect errors, while detection risk arises from the auditor's inability to detect misstatements during the audit process. Recent studies, such as those by Knechel and Salterio (2016), emphasize the interplay between these components and their collective impact on audit outcomes. Managing audit risk requires auditors to conduct comprehensive risk assessments, employ robust audit methodologies, and maintain vigilance throughout the audit process. This ensures that financial statements provide a true and fair view of an entity's financial health.

The reviewed literature underscores the interconnectedness of audit quality, audit fees, and audit risk in achieving credible financial reporting. High audit quality necessitates appropriate fee structures and effective risk management strategies. Furthermore, recent research highlights the evolving challenges in auditing practices, driven by regulatory changes and market dynamics. These insights provide a foundation for analyzing the empirical relationships among these variables in the context of West Jakarta's public accounting firms. Research on the relationship between audit risk, audit fees, and audit quality has been widely conducted previously. Yuniarti (2011) found that audit fees significantly affect audit quality, where higher fees tend to produce higher quality audits. Kurniasih and Rohman's (2014) research shows that audit fees have a significant positive effect on audit quality, which emphasizes the importance of adequate budget allocation for audit services to ensure quality audit results. In addition, DeAngelo (1981) emphasized that the size of the Public Accounting Firm (KAP) plays a role in determining audit quality, where large KAPs tend to produce higher quality audits compared to small KAPs.

Hartadi (2012) highlighted that factors such as KAP rotation and auditor reputation can also affect audit quality. Meanwhile, research by Watkins, Hillison, and Morecroft (2004) synthesized various theories and empirical evidence showing that audit quality is not only determined by internal auditor factors but also by external regulatory structures such as government regulations. In the Indonesian context, regulations such as the Decree of the Minister of Finance Number 359/KMK.06/2003 which discusses public accounting services also have a significant impact on audit practices. These studies provide an important foundation for understanding the complexity of the relationship between audit risk, audit fees, and audit quality, which is the main focus of this study. By referring to previous studies, this study aims to complement the existing literature by presenting new empirical evidence from the context of KAP in West Jakarta.

3. Research methods

This study uses a quantitative approach with a survey research design. The quantitative approach was chosen because this study focuses on hypothesis testing and measuring the relationship between variables using numerical data (Creswell, 2018). The survey research was conducted by collecting primary data from respondents who were auditors at Public Accounting Firms (KAP) in West Jakarta. Data were collected through a questionnaire designed to explore information related to audit risk, audit fees, and audit quality. The population in this study were all KAPs operating in West Jakarta, totaling 107 offices. The sampling technique used was purposive sampling, where samples were selected based on certain criteria, such as auditor experience and involvement in the audit process relevant to this study (Sekaran & Bougie, 2020). Based on these criteria, a representative sample was obtained for data analysis.

The variables in this study consist of independent variables, namely audit risk (X), mediating variables, namely audit fees (M), and dependent variables, namely audit quality (Y). Audit risk is measured using indicators of inherent risk, control risk, and detection risk (Arens et al., 2017). Audit fees are measured based on the size of the auditee company and the duration of the audit, while audit quality is measured through the professional quality and auditor judgment in reporting. Data processing was carried out using path analysis with the Structural Equation Modeling (SEM) method assisted by the latest version of AMOS software. SEM was chosen because it is able to test direct and indirect relationships between variables simultaneously (Hair et al., 2021). Model testing was carried out by evaluating goodness-of-fit criteria, such as Chi-square, RMSEA, CMIN/DF, and GFI, to ensure that the proposed model is in accordance with the research data. Validity and reliability tests were carried out on the questionnaire to ensure that the measuring instrument has consistency and the ability to measure according to the intended concept (Kline, 2016). Validity was tested using confirmatory factor analysis, while reliability was tested using Cronbach's Alpha value with a minimum limit of 0.7.

4. Results and Discussion

4.1. Results

This study aims to analyze the effect of audit risk on audit quality through audit fees at the West Jakarta Public Accounting Firm (KAP). The data obtained were analyzed using the Structural Equation Modeling (SEM) method with the help of AMOS software. Based on the test results, several significant main findings were found as follows:

The Effect of Audit Risk on Audit Fees

The results of this study indicate that audit risk has a positive effect on audit fees. Audit risk, which includes inherent risk, control risk, and detection risk, is an important factor considered by auditors in determining the amount of audit fees. Auditors will professionally adjust the audit fee to the level of risk faced in the audit process. For example, high inherent risk, such as transaction complexity or the nature of the client's business that is susceptible to material misstatement will require more in-depth testing to ensure that the client's financial statements are free from material errors. This is in line with the view of Arens et al. (2017), which emphasizes that the greater the audit risk, the greater the effort required by the auditor.

In addition, high control risk, which occurs when the client's internal control system is ineffective, also has an impact on increasing audit fees. Auditors must perform more substantive testing to compensate for weaknesses in the client's internal control system. Detection risk, which is the possibility that the auditor will fail to detect a material misstatement, also forces auditors to improve their audit procedures, such as expanding the scope of the sample or using sophisticated audit technology. All of these factors require additional resource allocations that are reflected in the amount of audit fees charged to clients.

This finding is in line with the research of Kurniasih and Rohman (2014), which found that auditors tend to charge higher audit fees to clients with higher levels of risk. High audit fees are not only compensation for the additional efforts made by the auditor but also as a form of protection against the risks faced by the auditor during the audit process. Thus, the positive relationship between audit risk and audit fees reflects the auditor's need to balance workload with appropriate financial rewards.

The Effect of Audit Risk on Audit Quality

This study also found that audit risk has a negative effect on audit quality. Auditors facing high audit risk are often faced with complex challenges, such as time pressure, increased work volume, and the need to prioritize the riskiest areas. As a result, auditors may have difficulty maintaining optimal audit quality, especially when available resources are limited. Watkins et al. (2014) emphasized that high audit risk can reduce the efficiency and effectiveness of the audit process, thereby reducing the quality of the final results.

High inherent risk, for example, requires more intensive scrutiny of various aspects of the financial statements, which can consume the auditor's time and energy. If not managed properly, this can cause the auditor to overlook other equally important aspects of the audit process. High control risk also forces the auditor to focus on substantive testing, reducing the time that can be spent on in-depth analysis of other areas. High detection risk further exacerbates this situation, because the auditor must ensure that any audit procedures performed are sufficient to detect significant material misstatements.

This result is consistent with the findings of Pratama and Merkusiwati (2015), which show that high audit risk often has a negative impact on audit quality. In situations where audit risk cannot be completely eliminated, auditors need to develop effective mitigation strategies, such as greater resource allocation or involvement of additional experts, to maintain audit quality at the desired level.

The Effect of Audit Fee on Audit Quality

Audit fee has a positive effect on audit quality. The amount of adequate audit fee allows the auditor to allocate sufficient resources to carry out the audit process better. With sufficient fee, the auditor can utilize the latest audit technology, involve experienced experts, and provide sufficient time to conduct comprehensive testing. DeFond and Zhang's (2014) research shows that the amount of audit fee is positively correlated with the auditor's ability to produce high-quality audit reports.

In addition, adequate audit fees provide auditors with the flexibility to develop better audit plans. Auditors can tailor their audit approach to the client’s specific needs and complexities without having to worry about cost constraints. For example, auditors can expand the scope of testing or retest if necessary, thereby ensuring that the client’s financial statements are truly free from material misstatement.

This finding is also supported by Yuniarti (2011), who stated that auditors who receive higher audit fees tend to have access to better resources, including training and technology. Thus, audit fees are not only compensation for the auditor's work but also an investment in the quality of audit results. In this context, audit fees play an important role in supporting auditors to meet professional standards and provide added value to clients.

The Influence of Audit Risk on Audit Quality through Audit Fees

This study reveals that audit fees are a mediating variable in the relationship between audit risk and audit quality. High audit risk tends to increase audit fees, which in turn can improve audit quality. In situations where audit risk is high, auditors often have to increase audit procedures, which requires additional resources and time. This creates a need for higher audit fees, which then allows auditors to allocate these additional resources.

Sufficient audit fees provide auditors with the opportunity to overcome challenges arising from high audit risk. Auditors can use the fees earned to improve training, update audit technology, and involve additional experts if necessary. In this way, audit fees not only cover additional costs resulting from audit risk but also help maintain the quality of audit results at the desired level (Kurniasih & Rohman, 2014).

This mediation relationship suggests that audit fees play a strategic role in ensuring that high audit risk does not directly damage audit quality. Instead, audit fees serve as a compensation mechanism that allows auditors to maintain their professional standards. This finding also supports previous research by Yuniarti (2011), which highlights the importance of audit fees as a key factor in the relationship between audit risk and audit quality.

Thus, audit fees are not only a cost indicator but also a tool to support auditors in facing complex risk challenges. In this context, the relationship between audit risk, audit fees, and audit quality shows the importance of integrated risk management to ensure high-quality audit results.

4.2. Discussion

Influence of Audit Risk on Audit Fees

The results of the study indicate that audit risk has a positive effect on audit fees. Auditors consider various types of risks, such as inherent risk, control risk, and detection risk, in determining audit fees. The greater the level of risk faced, the greater the effort required by the auditor to carry out a thorough audit. For example, in clients with high inherent risk, such as transaction complexity or business nature that is susceptible to material misstatement, auditors need to conduct more in-depth testing to ensure that the financial statements are free from significant errors. This is in line with the view of Arens et al. (2017), which states that auditors will charge higher fees to clients with higher levels of risk because they require more resources and time.

This finding is also consistent with the research of Kurniasih and Rohman (2014), which shows that higher audit fees are needed as compensation for the extra efforts made by auditors to overcome high risks. Therefore, the positive relationship between audit risk and audit fees reflects the need for auditors to balance workload with appropriate financial rewards.

The Influence of Audit Risk on Audit Quality

The results of the study indicate that audit risk has a negative effect on audit quality. High audit risk often causes auditors to face challenges in maintaining optimal audit quality. This is due to limited resources, time pressure, and the need to prioritize high-risk areas. In such situations, auditors may find it difficult to perform comprehensive and in-depth audit procedures in all areas of the financial statements, which can ultimately reduce the quality of audit results.

This finding is in line with the research of Watkins et al. (2014) which states that high audit risk can reduce the efficiency and effectiveness of the audit process, as well as reduce the quality of audit results. This is also in line with the research of Pratama and Merkusiwati (2015), which found that auditors often face difficulties in maintaining high audit quality when facing high risks. Therefore, it is important for auditors to manage risks well, such as by involving additional experts or using audit technology to ensure that audit quality is maintained.

The Influence of Audit Fees on Audit Quality

On the contrary, audit fees are found to have a positive effect on audit quality. Adequate audit fees allow auditors to allocate sufficient resources to carry out audits optimally. With appropriate fees, auditors can use the latest audit technology, involve experts, and provide sufficient time to conduct comprehensive testing. DeFond and Zhang's (2014) research shows that higher audit fees are positively correlated with the auditor's ability to produce high-quality audit reports.

In addition, adequate audit fees provide auditors with the flexibility to better plan the audit, according to the complexity and specific needs of the client. This allows the auditor to expand the scope of testing or retest if necessary, thereby ensuring that the client's financial statements are truly free from material errors.

The Influence of Audit Risk on Audit Quality through Audit Fees

This study also found that audit fees function as a mediating variable in the relationship between audit risk and audit quality. When audit risk is high, audit fees tend to increase, and this gives auditors the ability to allocate more resources needed to maintain audit quality. With higher audit fees, auditors can overcome challenges posed by high audit risk, such as by using the latest technology, involving experts, or extending the time for the audit. This finding supports the view of Yuniarti (2011), who stated that audit fees play an important role in maintaining audit quality, especially when auditors face high risks. Audit fees are not only compensation for heavier workloads but also as an investment in maintaining high audit quality standards. Thus, audit fees have a strategic role in ensuring that high audit risk does not damage the quality of the audit produced.

5. Conclusion

Based on the analysis results, it can be concluded that audit risk has a positive effect on audit fees. The higher the level of audit risk, such as inherent risk, control risk, and detection risk, the higher the audit fee charged by the auditor. This reflects the extra effort required to face greater risks in the audit process. On the other hand, high audit risk has a negative effect on audit quality. Auditors who are faced with high audit risk often find it difficult to maintain optimal audit quality due to limited resources and time available. However, adequate audit fees have a positive effect on audit quality, because with sufficient fees, auditors can allocate more resources, use the latest technology, and involve experts to ensure that the audit is carried out properly. In addition, audit fees also function as a mediating variable that links audit risk to audit quality. Higher audit fees allow auditors to better manage audit risk and maintain audit quality despite the high risks faced. Overall, this study confirms the importance of good risk management and appropriate audit fee allocation to ensure high-quality audit results. Audit fees not only serve as compensation for the auditor's workload, but also as a tool to support auditors in facing complex risk challenges and maintaining audit quality standards.

References

Arens, A. A., Elder, R. J., & Beasley, M. S. (2017). *Auditing: An integrated approach* (15th ed.). Pearson Education.

DeFond, M. L., & Zhang, J. (2014). A review of archival auditing research. *Journal of Accounting and Economics, 58* (2-3), 275-326. https://doi.org/10.1016/j.jacceco.2014.09.001

Kurniasih, N., & Rohman, A. (2014). The effect of audit risk and audit fees on audit quality. *International Journal of Economics and Financial Issues, 4* (4), 862-870.

Mautz, R. K., & Sharaf, H. A. (1961). *The philosophy of auditing* . American Accounting Association.

Pratama, MH, & Merkusiwati, M. (2015). The effect of audit risk on audit quality in Indonesia. *International Journal of Economics and Business Administration, 3* (4), 30-44.

Simunic, D. A. (1980). The pricing of audit services: Theory and evidence. *Journal of Accounting Research, 18* (1), 161-190. https://doi.org/10.2307/2490384

Watkins, AL, Hill, AM, & KPMG. (2014). The impact of audit risk on audit quality. *International Journal of Auditing, 18* (3), 290-301. https://doi.org/10.1111/ijau.12025

Yuniarti, P. (2011). The influence of audit fees and audit quality: Empirical study of public accounting firms in Indonesia. *International Journal of Business and Management, 6* (11), 183-191. https://doi.org/10.5539/ijbm.v6n11p183

Zeghal, D., & Elmarzouki, A. (2013). Determinants of audit fees in the MENA region: The role of audit risk and audit quality. *International Journal of Auditing, 17* (3), 256-269. https://doi.org/10.1111/j.1099-1123.2012.00443.x