

The Effect of Audit Expertise, Independence, and Competence on Audit Opinion: Evidence from Public Accounting Firms

Article info:

Received: January 22, 2020

Revised: March 25, 2020

Accepted: March 29, 2020

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Recommended citation:

Setianingsih, A. & Munari, M.
2020, The Effect of Audit
Expertise, Independence, and
Competence on Audit Opinion:
Evidence from Public Accounting
Firms, *Sustainable Business
Accounting and Management
Review*, 2(1), 54-60.

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ABSTRACT: *This study examines the effect of audit expertise, independence, and competence on audit opinion among auditors at public accounting firms in Surabaya, Indonesia, and identifies which of the three variables has the most dominant effect. Primary data were collected through a questionnaire administered to a sample of 42 auditors from 8 public accounting firms, selected through simple random sampling, and analyzed using multiple linear regression. All instruments were valid and reliable, and the classical assumption tests indicated the regression model was free of multicollinearity and heteroscedasticity, with normally distributed data. The results show that audit expertise, independence, and competence jointly and individually have a significant effect on audit opinion, explaining about 50.2 percent of its variance. Competence emerged as the most dominant variable, followed by independence and audit expertise. Audit expertise and competence were positively associated with audit opinion, while independence was significant but negatively associated with audit opinion, a counter theoretical result discussed in relation to the additional latitude greater independence gives an auditor in forming a judgment. These findings suggest that strengthening auditor competence offers the most direct path to more fair and objective audit opinions, and that efforts to build auditor independence should be paired with review mechanisms that help catch errors an independent auditor's own judgment might otherwise miss.*

Keywords: *Audit Expertise, Independence, Competence, Audit Opinion, Public Accounting Firm.*

INTRODUCTION

In the current era of globalization, the business world develops at an increasingly rapid pace, marked by the growing number of enterprises that are established and continue to grow in various forms. To sustain their existence, both sole proprietorships and other incorporated companies need to draw funds from outside parties, so that the parties interested in a company's financial statements are no longer limited to company leaders but extend to outside parties such as investors, creditors, prospective investors, and prospective creditors, as well as the government (Mulyadi, 2002).

Parties outside a company need information about that company to make decisions concerning their relationship with it, and they generally base such decisions on the information management presents in the company's financial statements. Two different interests are therefore at stake, since management wants to communicate information about how it has managed funds obtained from outside parties, while outside parties want reliable information from management about how the funds they have invested are being used. Information presented in financial statements must be fair, trustworthy, and free of anything misleading to its users so that the needs of every interested party can be met, and raising the reliability of a company's financial statements, together with establishing the fairness of the information they present, requires an examination carried out by an independent party so that the result of that examination is impartial.

Public accountants receive the trust of both the company being audited, or the client that pays the fee, and third parties with an interest in that company's financial statements, to audit those statements and give an opinion on whether they are fairly presented in accordance with the financial accounting standards set by the accounting profession. Suraida (2005) states that the end result of a public accountant's audit is the accountant's opinion, and that opinion must be supported by sufficient competent audit evidence, so that in gathering and analyzing audit evidence auditors must possess audit expertise and good competence in order to obtain convincing evidence as the basis for their opinion.

In practice, part of the public still doubts the level of expertise, competence, and independence held by auditors at public accounting firms, doubt that in turn affects public confidence in the opinions those auditors issue. This doubt is reflected in a number of accounting manipulation cases involving public accountants, both abroad and domestically, in recent years. Abroad, cases such as Enron and Arthur Andersen, and WorldCom, Xerox, and Merck and Arthur Andersen, drew wide attention. Enron, an energy giant with revenue of about 100 billion US dollars in the year 2000, suddenly collapsed and left behind debt of nearly 31.2 billion US dollars, a case that involved Arthur Andersen, one of the then Big Five public accounting firms that audited Enron's financial statements and had also been paid 52 million US dollars by Enron in 2000 for both audit and consulting services, raising the question of how the firm failed for years to detect material misstatement in Enron's financial statements, and whether it also failed in its underlying function of giving investors and creditors an objective and accurate picture of what was happening inside the company (Suraida, 2005).

Domestic cases can be seen in the license suspensions the Indonesian Ministry of Finance has imposed on a number of public accounting firms in recent years. Indonesia's Financial Audit Board has recorded that from 2004 to 2008, 154 auditors were sanctioned nationwide, with nine auditors sanctioned in 2004, fifty in 2005, eight in 2006, seventy nine in 2007, and eight in 2008. In one set of sanctions, the Minister of Finance suspended the licenses of two public accountants and one public accounting firm after they were found to have violated auditing standards, or the professional standards for public accountants, in ways judged to have materially affected the resulting independent auditor's reports, including failing to submit the firm's required annual business and financial activity reports. Episodes like these have raised doubt about the integrity of auditors at public accounting firms, even though auditors are continually required to comply with professional standards and to behave in accordance with the profession's code of ethics, which makes it important to examine what factors shape that attitude and behavior and how strongly those factors operate.

Users of public accounting firm services greatly hope that auditors will give an appropriate opinion, yet in practice an auditor's opinion still sometimes fails to meet the criteria set out in the profession's standards. In light of this, the present study is intended to determine what factors affect the opinion a public accountant gives when auditing a company's financial statements, and it accordingly asks whether audit expertise, independence, and competence affect a public accountant's audit opinion, and which of the three exerts the most dominant effect. This study contributes to the audit judgment literature by testing these three determinants together within a single regression model among practicing auditors at public accounting firms in Surabaya, Indonesia, rather than examining any one determinant in isolation.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Audit Opinion

An audit opinion is the conclusion drawn from an audit report and from the auditor's decision making process in the course of an audit. This part of an audit is so important that the entire audit report is often referred to simply as the auditor's opinion, and its purpose is to show that the conclusion reached rests on professional judgment (Arens & Loebbecke, 1997).

Audit Expertise

Audit expertise is the skill an auditor applies in following the standards, procedures, and examination techniques needed to carry out an audit of financial statements. Expertise, more broadly, is the ability to apply knowledge to problems commonly encountered and to resolve those problems without needing extensive further learning or meaningful help from other parties.

Independence

Independence means a mental attitude that is free from influence, not controlled by another party, and not dependent on anyone else. Independence also implies honesty on the part of the auditor in weighing facts, and an objective, unbiased consideration on the auditor's part in forming and expressing an opinion (Mulyadi, 2002).

Competence

Competence is defined as the personal characteristics of a worker that allow that worker to achieve superior performance. These personal characteristics include traits, motives, values, attitudes, knowledge, and skill, through which competence guides behavior and behavior in turn produces performance (Alim et al., 2007). In the present study, competence is measured through the adequate education and experience a public accountant holds in the field of auditing and accounting.

Audit Expertise, Independence, Competence, and Audit Opinion

Drawing on earlier research on the relationship between audit expertise and independence on one hand and audit opinion on the other, Mutchler (1985), as cited in Mayangsari (2003), points to an interdependent relationship between audit expertise and independence in the giving of an audit opinion, in the sense that auditors, whether competent or not, tend to give an inaccurate opinion when commercial pressures come into play, such as the risk of losing a client to another public accounting firm or pressure an auditor faces while carrying out an examination. The decision making process in an audit is shaped by audit expertise, competence, and independence together, where audit expertise relates to the structure of knowledge an auditor holds and can lead to differing audit opinions on a given case, while independence reflects the political, social, and economic pressure an auditor faces while forming an opinion. On this reasoning, an auditor must first possess expertise and competence before that auditor can act independently, since an auditor who lacks competence cannot realistically act independently in completing audit tasks and instead tends to depend on the opinions of others because of limited knowledge and experience.

This study builds on two premises drawn from earlier research. The first premise, following Christiawan (2002), is that audit quality is determined by two things, competence and independence. The second premise, following Mayangsari (2003), is that the decision making process in an audit is influenced by audit expertise and independence. Building on these premises, the present study focuses on audit expertise, independence, and competence as the variables expected to affect audit opinion.

H1: Audit expertise affects audit opinion.

H2: Independence affects audit opinion.

H3: Competence affects audit opinion.

In addition to testing H1-H3, this study also asks, as a research question rather than a separate hypothesis, which of the three variables, audit expertise, independence, or competence, exerts the most dominant effect on audit opinion.

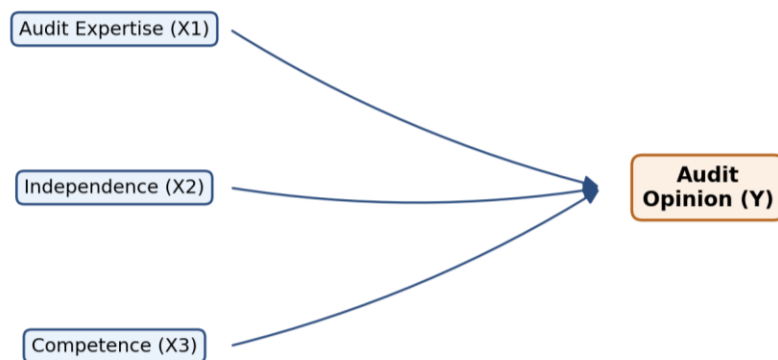


Figure 1. Conceptual Framework

METHOD

Variables and Measurement

The dependent variable in this study is audit opinion (Y), and the independent variables are audit expertise (X1), independence (X2), and competence (X3). Each variable was measured on an interval scale using a five point Likert technique, on which respondents chose a value from 1, indicating strong disagreement, to 5, indicating strong agreement. Audit expertise, independence, and competence were each measured with five statement items, while audit opinion was measured with eight statement items, all administered to auditors at public accounting firms in Surabaya, Indonesia.

Population and Sample

There were 43 public accounting firms registered in the 2009 Directory of Public Accounting Firms and Public Accountants in Surabaya, Indonesia, of which only 8 firms were willing to accept the study questionnaire. The population accordingly consisted of the auditors at those 8 firms, with each firm assumed to employ 9 auditors, for a population of about 72 auditors. A sample was drawn using simple random sampling, in which every member of the population has an equal chance of selection, with the sample size determined using Slovin's formula at a 10 percent margin of error (Umar, 2002). This procedure yielded a sample of 41.8, rounded to 42 auditors.

Data Collection

The study uses primary data obtained through a structured questionnaire distributed to auditors working at public accounting firms in Surabaya, Indonesia. Data collection proceeded in three stages: a preliminary stage in which information about the public accounting firms operating in Surabaya was gathered from the local secretariat of the Indonesian Institute of Certified Public Accountants, a preparation stage in which relevant literature was collected and studied, and an implementation stage in which the researcher visited each firm directly to distribute the questionnaire to auditors and collect the resulting data.

Data Analysis Technique

Instrument validity was assessed by correlating each item's score with the total score for its variable, using a corrected item total correlation, with an item considered valid where this correlation exceeded the *r* table value of 0.260. Instrument reliability was assessed using Cronbach's Alpha, with a variable considered reliable where its Cronbach's Alpha exceeded 0.60. Normality was assessed using the Kolmogorov Smirnov test, with a significance value above 0.05 indicating a normal distribution. Classical assumption testing covered multicollinearity, assessed using the variance inflation factor, with a value below 10 indicating no multicollinearity, and heteroscedasticity, assessed using Rank Spearman correlation between the regression residuals and each independent variable, with a significance level above 0.05 indicating no heteroscedasticity. An autocorrelation test was not carried out, because autocorrelation concerns the correlation between disturbance terms across time periods in time series data (Ghozali, 2006), whereas the data collected for this study are cross sectional rather than time series.

H1 was tested using multiple linear regression, following the equation $Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + e$, where Y is audit opinion, alpha is the constant, beta1 through beta3 are the regression coefficients for audit expertise, independence, and competence respectively, and e is the disturbance term. Model fit was assessed with the F test at a 0.05 significance level, together with the coefficient of determination (R squared). The research question concerning which variable is most dominant was addressed by comparing the partial t test results and the squared partial correlation of each independent variable, also at a 0.05 significance level, with the variable producing the largest squared partial correlation treated as the dominant variable.

RESULTS AND DISCUSSION

Respondent Characteristics

Questionnaires were completed by 42 auditors from the 8 public accounting firms in Surabaya, Indonesia that agreed to participate. By position, 8 respondents (19 percent) were senior auditors, 31 respondents

(74 percent) were junior auditors, and 3 respondents (7 percent) held other positions. By auditing experience, 36 respondents (86 percent) had less than 5 years of experience and 6 respondents (14 percent) had between 5 and 10 years of experience. By education, 3 respondents (7 percent) held a diploma degree, 32 respondents (76 percent) held a bachelor's degree, and 7 respondents (17 percent) held a master's degree. By ownership of a professional certificate outside the auditing field, 33 respondents (79 percent) held no such certificate and 9 respondents (21 percent) did, as summarized in Table 1.

Table 1. Respondent Characteristics (n = 42)

Characteristic	Category	n	%
Position	Senior auditor / Junior auditor / Other	8 / 31 / 3	19 / 74 / 7
Auditing experience	Less than 5 years / 5 to 10 years	36 / 6	86 / 14
Education	Diploma / Bachelor's / Master's	3 / 32 / 7	7 / 76 / 17
Other professional certificate	None / Held	33 / 9	79 / 21

Source: Processed primary data.

Validity and Reliability

Every item across the four variables produced a corrected item total correlation above the r table value of 0.260, so all items were retained as valid. Reliability, assessed with Cronbach's Alpha, is summarized in Table 2; every variable exceeded the 0.60 threshold and was accordingly treated as reliable.

Table 2. Validity and Reliability Results

Variable	Item Correlation Range	Cronbach's Alpha	Reliability
Audit Expertise (X1)	0.883 to 0.942	0.968	Reliable
Independence (X2)	0.789 to 0.927	0.936	Reliable
Competence (X3)	0.807 to 0.878	0.939	Reliable
Audit Opinion (Y)	0.429 to 0.634	0.778	Reliable

Source: Processed primary data.

Normality and Classical Assumption Tests

The Kolmogorov Smirnov test produced a significance value of 0.804, above the 0.05 threshold, indicating the data are normally distributed. The variance inflation factor for each independent variable, audit expertise at 2.845, independence at 3.275, and competence at 1.322, was well below the threshold of 10, indicating the regression model is free of multicollinearity. Rank Spearman correlations between the regression residuals and each independent variable produced significance levels above 0.05 for audit expertise, independence, and competence alike, indicating the model is free of heteroscedasticity. An autocorrelation test was not performed, since the data collected for this study are cross sectional rather than time series. Taken together, these results indicate the data support multiple linear regression analysis.

Multiple Regression Results

Table 3 presents the multiple linear regression results for the effect of audit expertise, independence, and competence on audit opinion.

Table 3. Multiple Linear Regression Results

Variable	Regression Coefficient	t (sig.)	Partial r-squared
Constant	30.014	n/a	n/a
Audit Expertise (X1)	0.314	3.816 (0.000)	0.276 (27.6%)
Independence (X2)	-0.418	-3.988 (0.000)	0.294 (29.4%)
Competence (X3)	0.306	5.096 (0.000)	0.405 (40.5%)

Source: Processed primary data (SPSS output).

The resulting regression equation is $Y = 30.014 + 0.314 X_1 - 0.418 X_2 + 0.306 X_3$. The constant of 30.014 indicates the predicted level of audit opinion when audit expertise, independence, and competence are all held at zero. The coefficient for audit expertise is positive, indicating that a one unit increase in audit expertise is associated with a 0.314 unit increase in audit opinion when the other two variables are held constant. The coefficient for competence is likewise positive, indicating that a one unit

increase in competence is associated with a 0.306 unit increase in audit opinion when the other two variables are held constant. The coefficient for independence, however, is negative, indicating that a one unit increase in independence is associated with a 0.418 unit decrease in audit opinion when the other two variables are held constant, a result discussed further below.

Model Fit and Coefficient of Determination

The F test produced an F value of 12.792, above the F table value of 2.852, with a significance level of 0.000, below the 0.05 threshold, indicating the overall regression model fits well in explaining the joint effect of audit expertise, independence, and competence on audit opinion. The coefficient of determination (R squared) was 0.502, indicating the three independent variables jointly explain about 50.2 percent of the variance in audit opinion, with the remaining 49.8 percent explained by factors outside the model.

Hypothesis Testing and the Dominant Variable

Table 3 also reports the partial t test results used to test H1 at the level of each individual variable. All three variables, audit expertise, independence, and competence, produced a t value beyond the t table value of 2.024 in absolute terms, each with a significance level of 0.000, so H1 is supported: audit expertise, independence, and competence all affect audit opinion, jointly and individually. Comparing the squared partial correlation for each variable in Table 3 shows that competence contributes the most to explaining audit opinion, at 40.5 percent, followed by independence at 29.4 percent and audit expertise at 27.6 percent, so competence is the most dominant of the three variables.

The positive and significant effect of audit expertise on audit opinion is consistent with expectations: the more developed an auditor's skill in applying auditing standards, procedures, and techniques, the more fair and objective the opinion that auditor is able to give. The positive and significant effect of competence, and its position as the most dominant of the three variables, likewise fits expectations, since competence, built on adequate education and experience in auditing and accounting, is a central requirement for a public accountant's ability to judge the fairness of the information management presents to users of financial statements.

The effect of independence is more complicated. Although independence is statistically significant, its coefficient is negative, meaning that as auditors in this sample reported greater independence, the audit opinion score tended to fall rather than rise. This result runs counter to standard auditing theory, which holds that the higher an auditor's independence, the more objective that auditor becomes in forming and expressing an opinion (Mulyadi, 2002). A plausible explanation is that greater independence gives an auditor more latitude and freedom in preparing an audit report, free from the influence of any other party, so that if an error occurs within that independent judgment, the resulting opinion can still end up harming the company, its clients, or other interested parties, since a highly independent auditor's judgment is not checked by outside influence in the way a less independent auditor's judgment might incidentally be. This finding suggests that independence, while a necessary condition for a credible audit opinion in principle, does not translate mechanically into a more favorable measured opinion score, and that the way independence was operationalized and interpreted by respondents in this study warrants closer attention in future research.

CONCLUSION

This study examined the effect of audit expertise, independence, and competence on audit opinion among 42 auditors at 8 public accounting firms in Surabaya, Indonesia. Audit expertise, independence, and competence were found to have a significant joint effect on audit opinion, explaining about 50.2 percent of its variance, and each of the three variables also had a significant individual effect, so H1 is supported. Competence emerged as the most dominant of the three variables, contributing 40.5 percent to explaining audit opinion, ahead of independence at 29.4 percent and audit expertise at 27.6 percent. Audit expertise and competence were both positively associated with audit opinion, consistent with theory, while independence was significant but negatively associated with audit opinion, a counter theoretical result plausibly explained by the additional latitude greater independence gives an auditor in forming a judgment that is not checked by any outside party.

For public accounting firms, these findings suggest that continuing to invest in auditor competence, through adequate education and accumulated audit and accounting experience, offers the most direct path to more fair and objective audit opinions, while the unexpected negative effect of independence indicates that firms should pair efforts to strengthen auditor independence with mechanisms, such as engagement quality review or structured second partner review, that help catch errors an independent auditor's own judgment might otherwise miss.

This study has several limitations. Differences in how individual respondents, as auditors, perceived and interpreted the context of the questionnaire statements may have affected their answers, and answers given in writing through a questionnaire do not necessarily reflect actual conditions as fully as direct observation or interviews would. Future research could address these limitations by supplementing the questionnaire with interviews, by extending the geographic scope of the study beyond Surabaya, and by examining auditor ethics or engagement review practices as a moderating variable that might help explain why greater independence was associated with a lower rather than a higher audit opinion score in this sample.

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