

International Conference on Accounting Studies 2014, ICAS 2014, 18-19 August 2014, Kuala Lumpur, Malaysia

An empirical analysis of auditor's industry specialization, auditor's independence and audit procedures on audit quality: Evidence from Indonesia

Iman Sarwoko^a, Sukrisno Agoes^{b*}

^a*Padjajaran University, Jl. Dipati Ukur, Bandung 40132, Indonesia*

^b*Tarumanagara University, Tanjung Duren Utara, Jakarta 11470, Indonesia*

Abstract

This study aims to investigate the influence of auditor's industry specialization, auditor's independence and audit procedures to detect fraud towards audit quality. This study applies explanatory research in which questionnaires and interviews serve as the primary data. The sample of this study is 50 public accounting firms which are registered in the Indonesian capital market. The results of this study depicted that auditor's industry specialization and auditor's independence have significant influence on the implementation of audit procedures to detect fraud, and the auditor's industry specialization, auditor's independence, and audit procedures to detect fraud have significant influence on the audit quality. Such results indicate that the measures to enhance audit quality can be taken by means of developing a competency in auditor's industry specialization, promoting auditor's independent mental attitude and implementing sufficient audit procedures to detect material fraud in a financial statements audit.

© 2014 The Authors. Published by Elsevier Ltd. This is an open access article under the CC BY-NC-ND license (<http://creativecommons.org/licenses/by-nc-nd/3.0/>).

Peer-review under responsibility of the School of Accountancy, College of Business, Universiti Utara Malaysia.

Keywords: Auditors' industry specialization; auditors' independence; audit procedures; audit quality; public accounting.

1. Introduction

* Corresponding author. Tel.: +081-680-8690; fax: +62-21-565-7531.

E-mail address: sukrisno.agoes@kapsukrinoagoes.com

Fraudulent financial reporting practice is a phenomenon that could not be overlooked in today's auditing. Common frauds among others are the manipulation of sales management, negligent to record debt, postponement of written-off, and intentionally reported false financial statements. As a result of these practices, in the United States in 2001 as many as 233 companies have to do a restatement on their financial statements which have been published (Pakenko, 2003). These cases are beyond the case of the financial scandals made by Enron, WorldCom, etc. in the United States in 2001 which overlooked independence and triggered audit failure. In Australia in the same year there was also uncovered financial scandal by HIH Insurance Company Group involving its external auditors (Leung et.al 2011). Similarly, in Indonesia, at the beginning of this century there were uncovered fraudulent practices in the company's financial reporting of PT. Indofarma Tbk in 2001 (www.tempointeraktif.com), PT. Bank Global Internasional Tbk in 2003 (www.tempointeraktif.com), PT. Indosat Tbk in 2004 (www.tempointeraktif.com) and others. Following these phenomena the accounting profession has always had trouble explaining to critics against their audit quality, why an audit conducted in accordance with professional standards might fail to detect a material misstatement of financial statements caused by fraud (Bragg, 2010:69).

One of the auditing standards set by the Indonesian Institute of Certified Public Accountants (IAPI) in order to improve the audit quality is Auditing Standards Section 316 "Consideration of Fraud in a Financial Statement Audit" an audit procedures to detect fraud risk in a financial statement that is an adoption of the Statement on Auditing Standards (SAS) No.82 issued by the AICPA in 1997. After the Enron case in 2001, the AICPA issued new SAS No. 99 as a replacement of SAS No.82 which is more detailed procedures in detecting fraud risk in a financial statements audit (Bragg, 2010:69-95). High-quality audit is very useful to produce reliable financial statements due to the high-quality auditing process could force the management whom intends to conduct fraud to implement the Generally Accepted Accounting Principles (GAAP) correctly. Therefore, reliable financial statements should show the highest quality of the auditors behind them, because the compliance with auditing standards is an auditor's professional responsibility in the audit of historical financial statements. Prior research suggest that for detecting fraud, an industry specialist auditor can perform an audit procedures for detecting fraud much better than non-specialist auditor, and that no matter how good the availability of auditing procedures it solely depend with the level of auditor's independence from the individual auditor during the audit process (Balsam et.al 2003)

Cases of financial scandals by public companies in Indonesia and other countries which could not be detected by the auditors as described above, can eventually lead to the decline of public confidence, especially investors in the capital market, on audit quality generated by a public accountant who provide an opinion about the fairness of the financial statements. This can be regarded as an audit failure which can endanger the public accountant profession if it is not be handled properly.

2. Literature review

2.1 Auditor's industry specialization

According to Arens et al. (2011:237), "Auditor specialization is auditor as having deep understanding (knowledge) and long experiences of the client's specific business and industry, having knowledge about the company's operations, and specific accounting and auditing guidance which are essential for doing a high quality audit. The nature of the client's business and industry affects clients' business risk and the risk of material misstatements in the financial statements". Tuanakotta (2011:213) and Cohan et al. (2010) states that: "Industry Specialist Auditor is auditor as having long experiences and deep understandings of how general and specific accounting guidance applies to the specific client's industry, and includes understanding of operational challenges and nuances of such industry. Rittenberg et al. (2010:21) and Balsam et al. (2003) argue that accounting firm that engage the auditor specialization in the audit process of its client in particular industry, will be able to select and implement audit procedures that are more precise and effective than the non-auditor specialization. The competence and expertness are obtained from repetition of the same audit procedures in certain industries for many years.

Wright and Wright (1997) and Libby and Frederick (1990) states that the more experience an auditor in a client's particular industry, it will enhance the ability of the auditor to suspect the existence of errors and fraud in financial statements audits by doing the analytical review procedures. The study results by Lin et al. (2010) and Owthoso et al. (2002) showed that assigning an auditor industry specialization in a particular client industry, will positively benefit the client because they can keep the quality of company earning better, which at last will increase the audit quality. Furthermore, Mayangsari, Sekar (2003) found that the auditor's industry specialization give significant influence on the reliability of the company's audited financial statements allegedly as a result of high-quality audits.

2.1.1 Auditor's independence

According to Arens et al. (2010: 134), "Auditor Independence is a mental attitude that is taking unbiased view point in the performance of audit tests during the accumulation and evaluation of evidences, the evaluation of the results, and the issuance of the audit report. Auditor independence has been assessed on two standards, that is, in-fact and in-appearance.

Mautz and Sharaf (1993:206) stated that: "Independence is a mental attitude that is free from the influence of others; it is not controlled by the other party, and does not depend on others. Auditor independence means the existence of honesty in considering fact, and dispassionate in the existence of an objective consideration to formulate and express opinions."

The following is a growing study of auditor independence, Paino et al. (2010) states that audit quality is affected by auditor competence and auditor independence in conducting a thorough examination to provide the auditor's opinion. Further research Nizarul et al. (2007) and Krishnamurthy et al. (2006) showed that auditor independence provides highest contributing on audit quality because in facing conflict of independence an auditor will apply professional scepticism, professional judgment and auditing standards guidelines including ethical standards fully in order to take a final decision

2.1.2 Audit procedures to detect fraud in a financial statements audit

Loebbecke et al. (1989), states that fraud is difficult to detect through audit procedures, because it usually involves concealment. Concealment is related to the accounting records and related documents, and usually as a response of fraud perpetrators to the auditor's request in an audit process. If the auditor asks for transactions evidence that contain fraud, the perpetrator will cheat by providing false or incomplete information.

According to the AICPA (Bragg, 2010:69-71) fraud detection method is one of the top priorities to be managed by public accountant and the regulator of professional standards in the United States, especially after the discovery of financial scandal (Enron, WorldCom, and others in 2001 and 2002). These circumstances resulted in Statements on Auditing Standards (SAS) No.82 issued by the AICPA in 1997 felt less effective, so in 2002 the AICPA issued a new auditing standard that is SAS No.99 "Consideration of Fraud in a Financial Statement Audit" instead. In SAS No.99 it is set more specific audit procedures, including brainstorming and red flags guidelines to detect and mitigate the fraud risk in financial reporting. The latter Auditing Standards has not been adopted in Indonesian Auditing Standards. The SAS No.99 does not change the auditor's responsibility in anticipating fraud as set out in SAS No.82, but adds new and more specific rules that must be performed by the auditor in detecting fraud.

From the study results by Gramling et al. (2001) it appears that Auditing Standards, particularly SAS No.99 including its attachments can assist auditors in detecting fraud risk in the financial statements, so that has a positive impact on the quality of the audit.

Carcello et al. (2004) stated that the participation of auditors specialization in the context of audit, affect positively on audit quality and reduce fraud because they understand the client's business and industry better, so they can create audit procedures of fraud detection which are tailor-made to the client's conditions.

2.1.3 Audit quality

According to Arens et al. (2011:105), “Audit Quality is how well an audit process detects and reports material misstatements in the financial statements. The detection aspect is a reflection of auditor competence, while reporting is a reflection of ethics or audit integrity, particularly independence”. DeAngelo (1981) defines audit quality as the probability that an auditor will both discover material misstatements in the client’s financial statements and truthfully report such material errors, misrepresentation, or omission in the client’s financial statements into their Auditor report for the users. According to the GAO (2003), audit quality is defined as one audit which is performed in accordance with generally accepted auditing standards (GAAS) to provide reasonable assurance that the audited financial statements and related disclosures are (1) presented in accordance with generally accepted accounting principles (GAAP) and (2) are not materially misstated whether due to errors or fraud. So, material deviation from the standards is presumed to reflect poor audit quality.

3. The model and hypotheses

3.1 Hypotheses

- Hypothesis- 1: Auditor’s industry specialization and auditor’s independence have influence on the audit procedures to detect fraud in a financial statement audit.
- Hypothesis- 2: Auditor’s industry specialization, auditor’s independence and audit procedures to detect fraud in a financial statement audit have influence on audit quality.

3.2 Theoretical model framework

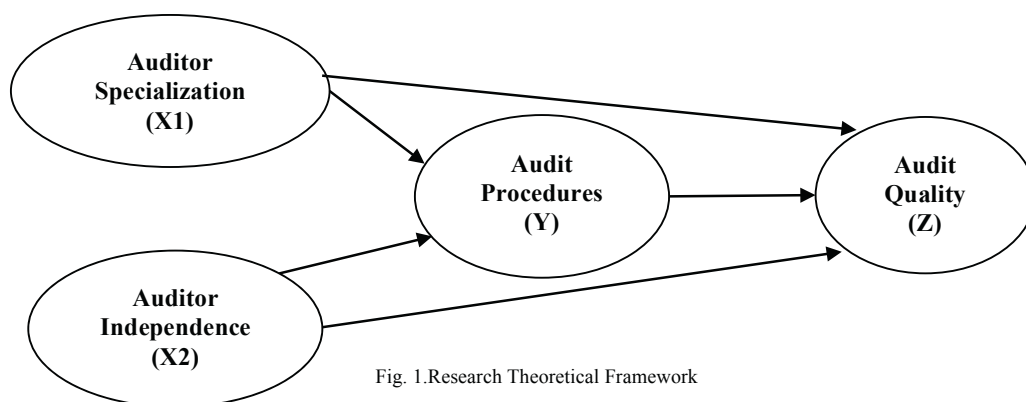


Fig. 1. Research Theoretical Framework

4. Research methodology

The conceptual model structure is presented in Fig. 1. This model is developed based on extensive literature review referring to the studies conducted in audit quality and relevant research results.

4.1 Variable operationalization

The concept of auditors industry specialization is an auditor who has had a deep understanding and long experiences to conduct an audit of the specific client's industry, thus becoming an expert in such clients' industry (Arens et al., 2011:237; Balsam et al., 2003). The criteria used to measure these variables are the deep understanding and long experience in auditing of a special client's industry. Furthermore, auditor's industry specialization is represented by the variable X₁.

The concept of auditor independence is a mental attitude that is free from the influence of other parties, and that is expected from a public accountant not to have a personal interest in the execution of his duty which is contrary to the principles of integrity and objectivity (Mautz & Sharaf, 1993:205). The independent mental attitude is used to measure this variable which is divided into the following three stages: (1) the planning stage, (2) the implementation stage, and (3) reporting stage of the audit. Auditor's Independence is represented by variable X_2 .

The concept of audit procedures to detect fraud in a financial statements audit is the audit procedures to be applied in accordance with auditing standards. The implementation of audit procedures to detect fraud risk can be measured in three levels: (1) fully implemented in accordance with Indonesian GAAS Section-316 (SPAP, 2011) and added with SAS No.99 (Bragg, 2010), (2) fully implemented in accordance with Indonesian GAAS Section-316 (SPAP, 2011) only, or (3) not fully implemented in accordance with Indonesian GAAS Section-316 (SPAP, 2011). Furthermore, the audit procedures to detect fraud in a financial statements audit are represented by the variable Y.

The concept of audit quality is a measurement of the ability of an audit process that is applied entirely based on GAAS, to ensure that the audited financial statements have been presented fairly in accordance with GAAP, and found no material misstatements in the financial statements due to errors or fraud (GAO, 2003). Can also be said that the Audit Quality is the probability that an auditor can do both, find and report honestly, material misstatements in the financial statements (DeAngelo, 1981). Measuring of audit quality in this study is conducted with several dimensions and indicators according to the research results by Schroeder et al. (1986) and Duff (2004:77). Audit quality is represented by the variable Z.

4.2 The sample of the study

Unit analysis of this study is public accounting firms which are registered in the Indonesian capital market. The selection of public accounting firms registered in the Indonesian capital market is based on the consideration that such public accounting firms are always be nurtured and monitored their professional and audit quality by the regulators, so it is expected that the respondents have audit quality who did not differ significantly.

The sampling technique applied is probability sampling, specifically random sampling technique. The size of the sample is 50 public accounting firms representing 30% from the total population of 163 public accounting firms registered in the Indonesian capital market. Sekaran, Uma (2000:250) remark that: "The response rate is almost always low. However, a 30% rate is quite acceptable". The respondents in this study are the audit partners. The reason behind the choices of audit partner is that they have reasonable experiences as a practicing auditor and have vast insights into their office conditions. DeFond and Francis (2005) argued that "The audit quality analysis can be pushed from the audit firm level down to the individual audit partner level"

The measurement scale implemented is multiple choice-single response scale and Likert's scale summated rating, with five scales ranging from constituting never (1) to always (5). The data is processed by using Lisrel 8.70.

Validity test based on the data processing results using Rank-Spearman Correlation (Siegel, 1994:256), the coefficient value of each of the 60 items in the questioner is higher than 0,30; it means that all items in the questioner are considered valid. Furthermore, the reliability test based on the data processing results using Split-half method from Spearman-Brown (Guilford, 1956:457), the reliability coefficient of all research variables are higher than 0,70, it means that all of the research variables are considered to have a high consistency level.

The analytical tool used in this research is Path Analysis with Lisrel 8.7 application program. A complete structural relationship between variables to be tested in this study can be seen in Fig. 2 as follows:

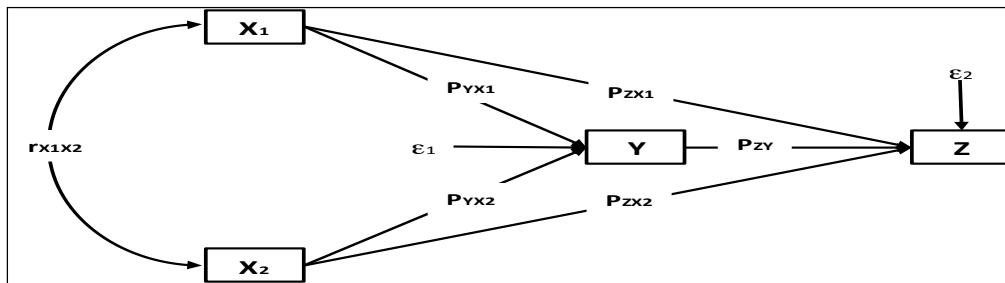


Fig. 2. Complete Structural Relationship between Research Variables

Description:

- $r_{X_iX_j}$: The relationship between X_i variable with X_j variable
 P_{YX_1} : Path coefficient of X_1 variable to Y variable
 P_{YX_2} : Path coefficient of X_2 variable to Y variable
 P_{ZX_1} : Path coefficient of X_1 variable to Z variable
 P_{ZX_2} : Path coefficient of X_2 variable to Z variable
 P_{ZY} : Path coefficient of Y variable to Z variable
 X_1 : Auditor's industry specialization
 X_2 : Auditor's independence
 Y : Audit procedures to detect fraud
 Z : Audit quality
 ε_1 : Other factors that influence the audit procedures
 ε_2 : Other factors that influence the audit quality

The computation process of path analysis will be using software Lisrel 8.70, and the path diagram in Fig. 2 could be formulated in 2 (two) structural equation model. The full equation model is as follows:

$$Y = P_{YX_1}X_1 + P_{YX_2}X_2 + \varepsilon_1$$

$$Z = P_{ZX_1}X_1 + P_{ZX_2}X_2 + P_{ZY}Y + \varepsilon_2$$

5. Data analysis and hypotheses testing

5.1 The hypothesis- 1: Auditor's industry specialization and auditor's independence have influence on the audit procedure to detect fraud in a financial statements audit

The analysis of the data is conducted by using path analysis. Based on path analysis calculation using Lisrel 8.70, the path coefficient of the auditors industry specialization variable (X_1) and auditors independence variable (X_2) toward audit procedures variable (Y) are 0,4487 and 0,4127, respectively. It is described in the following Table-1:

Table1.Path Coefficient of Independent Variable in First Sub Structure

Variable	Path Coefficient	t _{count}	$R^2 = 0,4941$
X_1	0,4487	4,0813	
X_2	0,4127	3,7546	

It means that together, the two independent variables (auditor's industry specialization and auditor's independence) influence the implementation of audit procedures to detect fraud by 49.41% (R^2 value). The remaining balance of 50.59% is influenced by other factors (such as auditors' size, audit tenure, audit fees, etc.). It is further described in a path diagram Fig. 3, as follows:

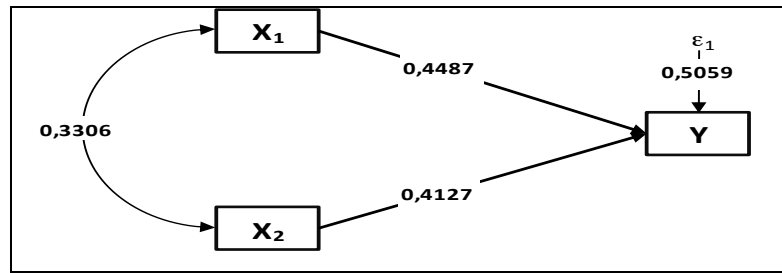


Fig. 3. Model Diagram Hypothesis-1: The influence of auditor's industry specialization (X1) and auditor's independence (X2) toward audit procedures (Y)

5.2 Auditor's industry specialization has influence on audit procedures to detect fraud

After the above path coefficient calculation, the t- test is conducted to measure the significance influence of auditor's industry specialization (X1) on audit procedures to detect fraud (Y). The following hypothesis is proposed:

$H_0 : \rho_{YX_1} = 0$ Auditors industry specialization has no influence on audit procedures to detect fraud

$H_a : \rho_{YX_1} \neq 0$ Auditors industry specialization has influence on audit procedures to detect fraud

As shown in Table-1, the influence of auditor industry specialization on the audit procedures to detect fraud is indicated by t_{count} value of 4.0813 and it is greater than t_{table} of 2.012 (The t-table of $\alpha = 0,05$ for the sample of 50 is 2,012). Since the value of t_{count} is greater than t_{table} , with the error rate of 5%, it was decided to reject H_0 and to accept H_a . So based on the testing results with 95% confidence level, it was concluded that the auditor's industry specialization significantly influence the audit procedures to detect fraud. With an understanding that the more experiences of auditors industry specialization, the more sensitive will be the implementation of audit procedures to detect fraud in a financial statements audit.

As shown in Fig. 3, the direct influence dimensions of auditor's industry specialization on the audit procedures to detect fraud is $(P_{YX_1})^2 = 0,4487 \times 0,4487 = 0,2013$ (20, 13%). While the indirect influence dimensions of auditor's industry specialization to the audit procedures to detect fraud, as it relates to the auditor's independence = $P_{YX_1} \times r_{X_1X_2} \times P_{YX_2} = 0,4487 \times 0,3306 \times 0,4127 = 0,0612$ (6,12%). So the total influence of auditor's industry specialization to the audit procedures to detect fraud = $20.13\% + 6.12\% = 26.25\%$ with a positive direction, it means that 26.25% changes that occurred in the variable of audit procedures to detect fraud can be explained or caused by the auditor's industry specialization variable.

5.3 Auditor's independence has influence on audit procedures to detect fraud

After the above path coefficient calculation, the t- test is conducted to measure the significance influence of auditor's independence (X1) on audit procedures to detect fraud (Y). The following hypothesis is proposed:

$H_0 : \rho_{YX_1} = 0$ Auditors independence have no influence on audit procedures to detect fraud

$H_a : \rho_{YX_1} \neq 0$ Auditors independence have influence on audit procedures to detect fraud

As shown in Table-1, the influence of auditor's independence on the audit procedures to detect fraud is indicated by t_{count} value of 3.7546 and it is greater than t_{table} of 2.012. Since the value of t_{count} is greater than t_{table} , with the error rate of 5%, it was decided to reject H_0 and to accept H_a . So based on the testing results with 95% confidence level, it was concluded that the auditor's independence significantly influence the audit procedures to detect fraud. With an understanding that auditor's independence boosts better implementation of audit procedures to detect fraud in a financial statements audit.

As shown in Fig. 3, the direct influence dimensions of auditor's independence on the audit procedures to detect fraud is $(P_{YX_2})^2 = 0.4127 \times 0.4127 = 0.1703$ (17.03%). While the indirect influence dimensions of auditor's independence on the audit procedures to detect fraud, as it relates to auditor's industry specialization $= P_{YX_2} \times r_{X_1 X_2} \times P_{YX_1} = 0.4127 \times 0.3306 \times 0.4487 = 0.0612$ (6.12%). So the total influence of auditor's independence on the audit procedures to detect fraud $= 17.03\% + 6.12\% = 23.15\%$ with a positive direction, it means that 23.15% changes that occurred in the variable of audit procedures to detect fraud, can be explained or caused by auditor's independence variable.

5.4 The hypothesis- 2: Auditor's industry specialization, auditor's independence and the audit procedures to detect fraud have influence on audit quality.

The analysis of the data is conducted by using path analysis. Based on path analysis calculation using Lisrel 8.70, the path coefficient of the auditor's industry specialization variable (X1), auditor's independence variable (X2) and the audit procedures to detect fraud variable (Y) on audit quality are 0,2265, 0,2233 and 0,5626, respectively. It is described in the following Table-2:

Table 2. Path Coefficient of Independent Variable in Second Sub Structure

Variable	Path Coefficient	t_{count}	$R^2 = 0,7412$
X ₁	0,2265	2,4754	
X ₂	0,2233	2,4915	
Y	0,5626	5,3922	

It means that together, the three independent variables (auditor's industry specialization, auditor's independence, and audit procedures to detect fraud) influence the audit quality by 74,12% (R^2 value). While the remaining balance of 25,88% is influenced by other factors beyond the above variables (such as auditors' size, audit tenure, audit fees, etc.). It is further described in a path diagram Fig. 4, as follows:

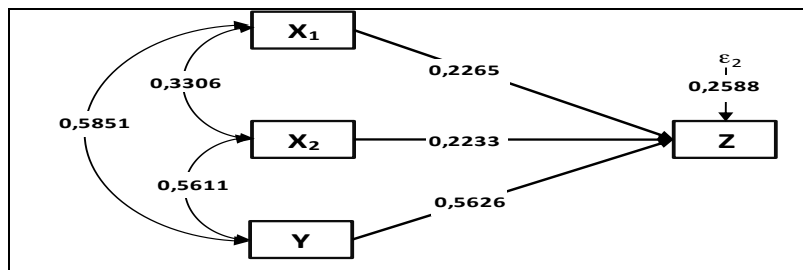


Fig. 4. Model Diagram Hypothesis-2: The influence of auditor's industry specialization (X1), auditor's independence (X2), and audit procedures (Y) on audit quality (Z)

5.5 Auditor's industry specialization has influence on audit quality

After the above path coefficient calculation, the t- test is conducted to measure the significance influence of auditor's industry specialization (X1) on audit quality (Z). The following hypothesis is proposed:

$H_0 : \rho_{YX_1} = 0$ Auditor's industry specialization has no influence on audit quality

$H_a : \rho_{YX_1} \neq 0$ Auditor's industry specialization has influence on audit quality

As shown in Table-2, the influence of auditor's industry specialization on the audit quality is indicated by t_{count} value of 2.4754 and it is greater than t_{table} of 2.012. Since the value of t_{count} is greater than t_{table} , with the error rate of 5%, it was decided to reject H_0 and to accept H_a . So based on the testing results with 95% confidence level, it was concluded that the auditor's industry specialization significantly influence the audit quality. With an understanding that the more experiences of auditor's industry specialization, the more improvement will be in the audit quality.

As shown in Fig. 4, the direct influence dimensions of auditor's industry specialization on audit quality is $(P_{ZX_1})^2 = 0.2265 \times 0.2265 = 0.0513$ (5.13%). While the indirect influence dimensions of auditor's industry specialization on audit quality because of its association with the auditor's independence $= P_{ZX_1} \times r_{X_1 X_2} \times P_{ZX_2} = 0.2265 \times 0.3306 \times 0.2233 = 0.0167$ (1.67%). The indirect influence of auditor's industry specialization on audit quality because of its association with the audit procedures to detect fraud $= P_{ZX_1} \times r_{X_1 Y_2} \times P_{ZY} = 0.2265 \times 0.5851 \times 0.5626 = 0.0746$ (7.46%). So the total influence of auditor's industry specialization on audit quality $= 5.13\% + 1.67\% + 7.46\% = 14.26\%$ with a positive direction, means that 14.26 % changes in audit quality variable can be explained or caused by auditor's industry specialization variable.

5.6 Auditor's independence has influence on audit quality

After the above path coefficient calculation, the t- test is conducted to measure the significance influence of auditor's independence (X2) on audit quality (Z). The following hypothesis is proposed:

$H_0 : \rho_{YX_1} = 0$ Auditor's independence has no influence on audit quality

$H_a : \rho_{YX_1} \neq 0$ Auditor's independence has influence on audit quality

As shown in Table-2, the influence of auditor's independence on the audit quality is indicated by t_{count} value of 2.4915 and it is greater than t_{table} of 2.012. Since the value of t_{count} is greater than t_{table} , with the error rate of 5%, it was decided to reject H_0 and to accept H_a . So based on the testing results with 95% confidence level, it was concluded that the auditor's independence significantly influence the audit quality. With an understanding that higher auditor's independence boosts higher audit quality.

As shown in Fig. 4, he direct influence of auditor's independence on audit quality $= (P_{ZX_2})^2 = 0.2233 \times 0.2233 = 0.0499$ (4.99%). While the indirect influence of the auditor's independence on audit quality because of the correlation with auditor's industry specialization $= P_{ZX_2} \times r_{X_1 X_2} \times P_{ZX_1} = 0.2233 \times 0.3306 \times 0.2265 = 0.0167$ (1.67%). The indirect influence of auditor's independence on audit quality because of the correlation with audit procedures to detect fraud $= P_{ZX_2} \times r_{X_2 Y} \times P_{ZY} = 0.2233 \times 0.5611 \times 0.5626 = 0.0705$ (7.05%). So the total influence of auditor's independence on audit quality $= 4.99\% + 1.67\% + 7.05\% = 13.71\%$ with a positive direction, it means that 13.71 % changes in audit quality variable can be explained or caused by auditor's independence variable.

5.7 Audit procedures to detect fraud have influence on audit quality

After the above path coefficient calculation, the t- test is conducted to measure the significance influence of audit procedures to detect fraud (Y) on audit quality (Z). The following hypothesis is proposed:

$H_0 : \rho_{YX_1} = 0$ Audit procedures have no influence on audit quality

$H_a : \rho_{YX_1} \neq 0$ Audit procedures have influence on audit quality

As shown in Table-2, the influence of audit procedures to detect fraud on audit quality is indicated by t_{count} value of 5.3922 and it is greater than t_{table} of 2.012. Since the value of t_{count} is greater than t_{table} , with the error rate of 5%, it was decided to reject H_0 and to accept H_a . So based on the testing results with 95% confidence level, it was concluded that the audit procedures to detect fraud significantly influence the audit quality. With an understanding that the more appropriate the implementation of audit procedures to detect fraud in a financial audit, the more improvement will be in the audit quality.

As shown in Fig. 4, the direct influence dimensions of the audit procedures to detect fraud on audit quality $= (P_{ZX})^2 = 0.5626 \times 0.5626 = 0.3165$ (31.65%). While indirect influence dimensions of the implementation of audit procedures to detect fraud on audit quality because of its association with auditor's independence $= P_{ZX} \times r_{X_2 Y} \times P_{ZY} = 0.5626 \times 0.5611 \times 0.2233 = 0.0705$ (7.05%). Indirect influence dimensions of the audit procedures to detect fraud on audit quality because of its association with auditor's industry specialization $= P_{ZX} \times r_{X_1 Y} \times P_{ZX_1} = 0.5626 \times 0.5851 \times 0.2265 = 0.0746$ (7.46%). So the total influence of the audit procedures to detect fraud on audit quality $= 31.65\% + 7.05\% + 7.46\% = 46.16\%$ with a positive direction; it means that 46.16% changes in audit quality variable can be explained or caused by audit procedures to detect fraud variable.

6. Conclusion

The significant influence of auditor's industry specialization on audit procedures to detect fraud in a financial audit and towards audit quality reflects that the auditor has a deep understanding and long experiences on the clients' specific industry including their specific accounting principles, business process, business risk and the risk of material misstatement in the financial statements. The capability of auditor in such a specific industrial field of client will enable him to effectively select and implement audit procedures to detect material fraud that are precise and tailor made with the client condition resulting a higher quality audit. In term of the significant influence of auditor's independence on audit procedures to detect fraud in a financial statements audit and towards audit quality reflects that the auditor has an absolute unbiased mental attitude that needs to be maintained, which is independence. Such attitude keeps the auditor in the right track in implementing properly the audit procedures to detect material fraud in a financial statements audit, in making decision throughout the audit process, and in preparing the final report to achieve a high quality audit. Finally in term of the significant influence of audit procedures to detect fraud on audit quality reflects that the auditor fully aware of the impact of the audit failure, they do not want to be found negligent in litigation against alleging inadequate audit procedures to detect fraud. Furthermore, audit quality is often related to the ability of the auditor to detect material misstatement in the financial statements due to error or fraud. Thus, in order to produce high level of audit quality requires effort from both the professional bodies to provide a properly standard auditing procedures and the accounting firm to provide highly experienced and skilled staff with independence mental attitude.

References

- Arens, A. A., Best, P., Shailer, G., Fidler, B., Elder, R. J., & Beasley, M. S. (2011). *Auditing Assurance Services in Australia: An Integrated Approach*. 8th edition. Pearson Australia, NSW 2086.
- , Mark. S. Beasley & Randal. J. Elder. (2010). *Auditing and Assurance Services: An Integrated Approach*. 13th edition. Upper Saddle River, NJ: Prentice Hall.
- Balsam, S., J. Krishnan, & J. S. Yang. (2003). Auditor Industry Specialization and Earning Quality. *Auditing: A Journal of Practice & Theory*. Vol. 22, No.2:71-91.
- Bragg, M. Steven. (2010). AICPA (American Institute of Certified Public Accountants)'s GAAS. *Practitioner's Guide to GAAS-2010 – Section 316 (SAS No. 99 and SAS-82), "Consideration of fraud in a financial statement audit"*. Edition for 2010. John Wiley & Sons, Inc., Somerset, New Jersey.
- Carcello, J.V., & A.L. Nagy. (2004). Audit Firm Tenure and Fraudulent Financial Reporting. *Auditing: A Journal of practice & Theory*. Vol.23. No. 2:55-69.
- Cohan, S.F., Jeter, D.C., & Naiker, V. (2010). Are All Industry Specialist Auditors The Same? *Working Paper at Auckland Business School, University Of Auckland*. NZ.
- DeAngelo, L.E., (1981). Auditor Independence, low balling, and Disclosure Regulation. *Journal of Accounting and Economic*. Vol.3. No.2 (August): 113-127.
- DeFond, M.L., & Francis, J. R. (2005). *Audit Research after Sarbanes-Oxley*. *Auditing: A Journal of Practice & Theory*. Vol.24 (Supplement): 5-30.
- Duff, Angus. (2004). *Understanding Audit Quality: The View of Auditors, Auditees and Investors*. First published in 2004, by The Institute of Chartered Accountants of Scotland, CA House, 21 Haymarket Yards, Edinburgh. Great Britain, Antony Rowe Ltd.
- GAO, (US. Government Accountability Office). (2003). *Public Accounting Firm*. Report No.GAO-03-864, <http://www.gao.gov> (Accessed 21/12/ 2010).
- Gramling, A.A., V.E., Johnson, & I.K., Khurana. (2001). *The Association between Audit Firm Industry Experience and Financial Reporting Quality*. Working paper, Georgia State University.
- Guilford, J.P., Benjamin Fruchter. (1956). *Fundamental Statistic in Psychology and Education*, 5th Edition, Tokyo, Mc-Graw Hill.
- Krishnamurthy, S., Jian Zhou & Nan Zhou. (2006). Audit Reputation, Auditor Independence and the Stock Market Reaction to Andersen's Client. *Contemporary Accounting Research*, Vol 23 No. 2: 465-490.
- Leung, P., Coram, P., Cooper, B.J. & Richardson, P. (2011). *Modern Auditing and Assurance Services*. 5th Edition, John Willey & Sons Australia, Ltd. Milton Qld.
- Lin, Jerry W., & Mark I. Hwang, (2010). Audit Quality, Corporate Governance, and Earnings Management: A Meta- Analysis. *International Journal of Auditing*, Vol.14 (1): 55-77.
- Libby, Robert & Frederick, David, M., (1990). Experience and the Ability to Explain Audit Findings. *Journal of Accounting Research*, Vol.28 No. 2: 348-367.

- Loebbecke, J.K., M.M., Eining & J.J., Willingham. (1989). Auditors Experience with Irregularities: Frequency, Nature and Detect ability. *Auditing: A Journal of Practice & Theory*, Vol.9 (Fall): 1-28.
- Mayangsari, S., (2003). An analytical review of the influence of auditor's independence on audit quality and the corporate governance mechanism. *National Accounting Symposium VI*, Surabaya, October 16-17, 2003.
- Mautz, R. K., & Sharaf, H.A., (1993). The Philosophy of Auditing. Thirteenth Printing, *American Accounting Association; Monograph No. 6*. Sarasota, FL, USA.
- Nazir, M., (2011). *Research Methods for Business*. 7th edition, October 2011, Ghalia Indonesia Publisher, Ciawi-Bogor, 16720.
- Nizarul, M., A., Hapsari, & Purwanti. (2007). An empirical analysis of auditor's competence and auditor's independence on audit quality, with an ethical code as moderating variable. *Finance and Accounting Journal*, Vol.11. No.1, May 2007: 13-30.
- Owhoso, V.E., Messier, jr. W.F., & Lynch, jr J.G. (2002). Error Detection by Industry Specialized Teams during Sequential Auditor review. *Journal of Accounting Research*. Vol. 40. No.3, June 2002: 883-900.
- Paino, Halil, Smith, M., & Ismail, Z. (2010). *The Search for Audit Quality, Impairment of Audit Quality*. Published by LAP Lambert Academic Publishing, Germany: 37-38.
- Pakenko, Boris. (2003). Fraudulent Financial Reporting; Ways to Detect and Interpret The Warning Signals. *International Business Standard and Corporate Governance*. Training Paper, Ukraine. USAID. September 2003.
- Rittenberg, L.E., Johnston, K.M. & Gramling, A.A. (2010). *The Public Accounting Profession: Auditing, a business Risk Approach*, 7th Edition, South Western Engage Learning, Mason USA: 21- 22.
- Schroeder, M., I. Solomon, & D. Vickrey. (1986). Audit Quality: The Perceptions of Audit Committee Chairpersons and Audit Partners *Auditing: A Journal of Practice and Theory*, Vol.5, No.2:86-94.
- Siegel, Sidney. (1994). *Non parametric Statistic for the behavioural Sciences*. (Translated by Zanzawi Suyuti), Six Edition, February 1994. Published by PT Gramedia Pustaka Utama. Jakarta.
- Sekaran, Uma. (2010). *Research Methods for Business, A Skill-Building Approach*. Fourth Edition. John Wiley and Sons, Inc. New York, NY.
- SPAP, (2011). (Published by IAPI or the Indonesian Institute of Certified Public Accountants). The Professional Standards of Public Accountants (SPAP), SA Section-316 (PSA No.70), Consideration of Fraud in a Financial Statements Audit. March 31, 2011's Edition, Salemba Empat Publisher, Jakarta.
- Tempointeraktif, (2001). BEJ closed the suspension of PT. Semen Gresik and PT. Indofarma. Accessed from: <http://www.tempointeraktif.com>. (2/3/2010).
- , (2003). BEJ froze the license to operate from the external auditor of PT. Bank Global. Accessed from: <http://www.tempointeraktif.com>. (2/3/2010).
- , (2004). Bapepam rendered an administrative sanction on PT Indosat for their legal cases. Accessed from: <http://www.tempointeraktif.com> (2/3/10).
- Tuanakotta, T.M., (2011). *Critical Thinking in Auditing*. 1st edition, Salemba Empat Publisher, Jakarta. 12610.
- Wright, S. & Wright, A.M. (1997). The effect of auditors' industry specialization on hypothesis generation and audit planning decisions. *Behavioural Research in Accounting*. Vol.9:273-294.