

*FACTORS AFFECTING AUDIT ENGAGEMENT DECISION
(STUDY ON CPA FIRMS IN SURABAYA)*

Rudiana Fibriani

Universitas Pembangunan Nasional “Veteran” Jawa Timur
rudiana.fibriani@gmail.com

ABSTRACT

The study was conducted to examine and analyze whether audit risk, auditor’s independence, auditor’s business risk, and client’s business risk affect the decision to audit engagements acceptance. Quantitative analysis conducted with data collection techniques using questionnaires. 97 respondents were partners of accounting firms in Surabaya. The results of this study are audit risk, auditor independence, and client’s business risk have a significant effect on audit engagement acceptance. While the auditor’s business risk has a positive but insignificant effect on audit engagement acceptance.

Keywords: Audit Risk, Auditor independence, Auditor Business Risk, Client Business Risk and Audit Engagement Acceptance

INTRODUCTION

Public has great confidence in public accountants’ audit financial statements. Public accountants conduct audits to ensure that financial statements are presented fairly consistently in accordance with Financial Accounting Standards or Accounting Principles. Therefore, Public Accounting Firms must always maintain their independent professional services as regulated in the Public Accountant Professional Standards by the Indonesian Institute of Certified Public Accountants (IAPI).

Public accountants are responsible for increasing the level of reliability of the company's financial statements, because the interested parties both from the internal and external the company expect transparency regarding the company's financial statements so that the information produced will be useful in decision-making.

The financial reports as the result of an audit must be guaranteed by independent professional services, which can improve the quality of the information. The objectives of the audit according to International Standards on Auditing (ISA) 200 are: to obtain reasonable assurance about whether the financial statements -as a whole- are free from material misstatement -whether

due to fraud or error-, and to enable the auditor to express an opinion on whether the financial statements are prepared materially in accordance with with the applicable financial reporting framework and reporting on financial statements and communicating everything in accordance with the auditor's findings. Although material misstatements may not be revealed during the audit process, but there is a possibility that they will be revealed when the audit opinion has been issued (Huss, et al. 2000).

The collapse of the world's leading companies, Enron, made public accountants the target of public criticism, so that public confidence in the public accounting profession and the results of its financial statements faded, especially in the business world. Under conditions of extreme uncertainty and intense competition, there is a potentially higher risk that CPAs may face in acquiring "virgin clients". Although a similar big case like Enron haven't happened in Indonesia, but Indonesian public accountants face similar risk.

This risk can be reduced if they are able to identify and evaluate the risk, and consider the possibility of misstatement. So that audit risk management is important as a consideration for accepting or rejecting new clients. In the case of Enron, moral hazard behavior occurred, the financial statements were manipulated by recording a profit of US\$ 600 million when in fact the company suffered a loss. This irresponsible act occurred because Enron wanted its shares to remain attractive to investors. The conflict of interest intervention causes auditors to lose their independence. The result of survey conducted by Transparency International shows that 92% of respondents think corruption is a big problem, and it placed Indonesia in rank 96 of 180 most corrupted countries. This means that if Indonesian public accountants don't have independence, similar cases like Enron may happened in Indonesia.

Understanding the client's business and industry is a very important aspect of audit planning. Auditors must acquire sufficient knowledge and understanding of the client's business and industry to understand events, transactions, and facts that may have a significant influence on the financial statements (Boynton et al, 2003:164). Failure to understand the client's financial environment and habits will be quite burdensome in examining the client's financial statements because the auditor can face many problems due to client risks that are not known to the auditor. Kynveld Peat Marwick Goerdeler (KPMG) Public Accounting Firm decided to discontinue the engagement with its client when experiencing problems in handling tax cases due to lack of understanding of the client's environment and habits.

Good procedures and judgment in accepting clients are very important keys to reducing the business risk of CPA Companies facing future lawsuits. Therefore, it is very important to understand and carefully evaluate the condition of the client company before deciding to accept a client because it has a direct impact on the risk of conducting the audit.

This study examines the gap of previous research conducted by three researchers, namely Rajagukguk (2017) examining the effect of audit risk variables, client business risk, and auditor business risk on client acceptance at the CPA Office and concludes that the better the audit risk, the higher the client acceptance rate, whereas the higher the client's business risk, the lower the client acceptance rate. Meanwhile, Selvina's research (2017) revealed that based on the results of the six variables studied (management integrity, client business risk, audit risk, audit fees, and client acceptance decisions) at KAP Non-Big 4 CPA, client business risk had no effect on client acceptance decisions.

LITERATURE REVIEW

Audit Risk

Arens, et.al (2007:258) states that audit risk occurs when the auditor experiences a certain level of uncertainty in the audit, such as uncertainty regarding the competence of audit materials, the effectiveness of the organizational structure of internal control, and uncertainty whether the financial statements have been presented fairly after the audit is complete. . Halim (2003: 126-127) explains that audit risk is the risk that occurs when the auditor does not realize that he does not properly modify his opinion on material misstatements in the financial statements. This risk can occur due to errors or fraud, which can be carried out by company employees or by management in the form of engineering financial statements.

The Indonesian Professional Standards for Certified Public Accountants (SPAP) stipulates that the auditor is responsible for planning and performing the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement, whether caused by error or fraud. Auditing Standard 200 (SA 200) states that fraud and error are distinguished based on whether the action that underlies the misstatement in the financial statements is an intentional or unintentional act.

According to Halim (2003: 128) three components of audit risk generally consist of:

1. Inherent Risk; is the susceptibility of an assertion to material misstatement assuming that there are no related internal control structure policies and procedures.
2. Control Risk; is the risk that a material misstatement that could occur in an assertion cannot be detected or prevented on a timely basis by the company's internal control policies and procedures.
3. Detection Risk; is the risk that the auditor will not detect a material misstatement embodied in an assertion and is dependent on the auditor's determination of audit risk, inherent risk, and control risk.

The definition of audit risk does not include the risk faced by the auditor because he or she incorrectly concludes that the financial statements are materially misstated. At this time, the auditor usually reconsiders or expands his audit procedures and asks the client to perform certain tasks to re-evaluate the fairness of his financial statements. These steps will lead the auditor to the correct conclusion. Regarding audit risk and materiality, the International Standards on Auditing (ISA) states that management is responsible for identifying risks and responding to them, rather than all risks associated with the preparation of financial statements. The auditor only responds to risks that affect the statement of financial statements, the auditor obtains and evaluates audit evidence to obtain reasonable assurance about whether the financial statements provide a true and fair view or are presented fairly in all material respects in accordance with the applicable financial reporting framework. The definition of audit risk referred to in this amendment is the risk that the auditor expresses an inappropriate audit opinion when the financial statements are stated to be materially misstated.

Hastuti & Indarto(2014) found that the consideration of audit risk is significantly and negatively associated with the decision of acceptance or rejection of the assignment of auditing the financial statements of the client. Rajagukguk (2017) concludes that the better the audit risk, the higher the client acceptance rate. Selvina (2017) research shows the results that audit risk has an effect on client acceptance decisions at a Non Big 4 KAP. This three studies are the only research in the recent decade that specifically studied the effect of audit risk and audit engagement acceptance.

Auditor Independence

Carey (1946) defines CPA independence in terms of the integrity and opinion of accountants on financial statements. The essence of independence is a mental attitude that is free from influence, uncontrolled, and independent from others. Independence shows the auditor's honesty in considering facts and impartial objectivity in formulating and expressing his opinion.

The independence of public accountants is the main basis of public trust in the public accounting profession and is one of the most important factors in assessing the quality of audit services. The independence of public accountants includes two aspects, namely: independence of mental attitude; and independence of appearance where accountants must avoid factors that can give the public the impression of doubting their independence (Mautz& Sharaf, 1961:204-205).

Ibid. also argues that the independence of public accountants also includes (1) practitioner independence, which is related to the ability of individual practitioners to maintain a fair or impartial attitude in the planning, preparation, and implementation of programs, and in auditing and verification reports. This independence includes three dimensions; and (2) Professional independence related to the public's impression of the public accounting profession.

In the recent decade, there is no specific research that examines the relationship between auditor independence and audit engagements acceptance.

Auditor's Business Risk

According to Simamora (2002:99) the risk faced by the auditor is defined as the auditor's exposure to professional loss or damage due to litigation, bad publicity, or other events that arise in connection with the audited and reported financial statements.

The risk when a CPA suffers a loss due to an engagement or in other words a lawsuit occurs from other practices that demand the reliability of financial statements, on an audit report made for a client who is declared an unqualified opinion, for example a lawsuit by a party who feels aggrieved due to the use of the service from the CPA, the penalty imposed by a professional organization. The auditor's business risk can be:

1. An audit error that occurs when the business is unable to repay borrowers or is unable to meet shareholder expectations due to economic conditions or unforeseen competition in the industry.

2. The auditor issues an incorrect audit opinion because it does not meet the requirements listed in Generally Accepted Auditing Standards (GAAS), as well as audit risk by taking into account the risks faced by the auditor stating that the financial statements are correct so that the auditor's opinion is not of good quality which has been issued but on the fact that the report is untrue and the materiality level is high.

CPAs face risks from providing their services as auditors, in connection with their services being very vulnerable or with a high level of risk by risking their reputation or business risk in providing services or accepting clients for listed companies. Johnstone (2000:3) proposes several methodologies in controlling risk with the client's business, one of these methods is managing risk by assigning a special team or specialization according to the type of client's business, utilizing professional billing strategies, using complex audit techniques and implementing policies. specific monitoring.

Colbert et al, (1996) also explained that some of the high-risk factors include the client's condition and the high number of prosecution cases faced by the client. Auditors have the ability to control their business risks carefully in accepting these clients for the continuity of their business in the future, in an effort to reduce risks with clients who are potentially high risk, CPA must have specific procedures in conducting audits. Standard audit professionalism in accepting clients must go through established procedures, further Johnstone and Bedard (2003) propose several methodologies in controlling risk with the client's business, one of these methods is managing risk by assigning a special team or specialization according to the type of client business, utilize professional billing strategies, employ complex audit techniques and implement specific monitoring policies.

In addition to audit risk, the auditor also faces the risk of loss of professional practice as a result of lawsuits, negative publications or other events that arise in relation to the financial statements that have been audited and reported.

In the recent decade, there is no specific research that examines the relationship between auditor's business risk and audit engagements acceptance.

Client's Business Risk

Arens et.al (2007) defines client business risk as the risk that the client fails to achieve its objectives related to reliability of financial reporting, efficiency and effectiveness of operations as

well as compliance with law and government. In his book, Colbert et al (1996) wrote that the factors that determine client business risk are client management, especially those related to integrity, business entities related to company operations and finances as well as client industries such as regulatory, competitive and other industrial aspects.

When performing an audit of financial statements, the auditor shall obtain sufficient prior knowledge of the client's business to enable the auditor to identify and understand events, transactions and practices that in the auditor's judgment may have a significant impact on the financial statements or on the audit report. This knowledge is used by the auditor in assessing risk, either inherent risk or control risk and in determining the nature, timing and extent of audit procedures. The auditor's level of knowledge for an engagement includes general knowledge of the economy and industry in the entity's operational areas and more specific knowledge of how the entity operates even though in reality the level of knowledge required of the auditor is usually lower than that of management. Prior to accepting an engagement the auditor will obtain preliminary knowledge of the industry and ownership, management and operations of the entity to be audited and will consider whether the level of knowledge about the business is adequate to perform the audit to be obtained. By considering the business risks that they may face, auditors tend to reject clients who will threaten their business (Wondabio, 2006).

Furthermore, in order to understand the client's business risks, according to ISA section 315, it is stated that knowledge about business is a frame of reference used by auditors to carry out professional judgments. An understanding of the business and the use of that information can assist the auditor in:

- 1) Risk assessment and problem identification
- 2) Effective and efficient audit planning and implementation
- 3) Evaluation of audit evidence
- 4) Providing better services for clients

Hastuti & Indarto(2014) found that client's business risk considerations are associated positively and significantly with the decision of acceptance or rejection of the assignment of auditing a client's financial statements. Rajagukguk (2017) concludes that the higher the client's business risk, the lower the client acceptance rate. Selvina's research (2017) revealed that client business risk had no effect on client acceptance decisions. Suryani & Sitorus (2018) found that

client risk directly affects the acceptance of the audit engagement in a positive and significant way.

Audit Engagement Acceptance

When accepting an audit engagement, auditors must have professional responsibilities to public, and members of the accounting profession by maintaining independence, integrity, and objectivity where the client's interests must be met with professional competence and attention, therefore the decision to accept an audit client should not be taken lightly.

Considerations to accept or reject a work engagement need to pay attention to inquiries from the predecessor auditor whether the client has been audited by a previous auditor, where this is a procedure that needs to be carried out because it can provide useful information to the successor auditor in considering making a decision to accept or reject the engagement. and to anticipate that the predecessor auditor and the client may have differences of opinion regarding the application of accounting principles. The successor auditor should seek permission from the prospective client to request confidential information from the predecessor auditor prior to acceptance of the engagement so that the procedure can provide communication guidance to the successor auditor when misstatements may be found in the financial statements reported by the predecessor auditor in the event the successor auditor is considering accepting or refuse the engagement.

After the decision to accept or reject an audit engagement, the CPA must manage the business risks on their own. The most important part of the CPA's quality control is the internal procedures that make it possible for the CPA to make the decision to accept or reject the engagement. Conditions that may cause a CPA to withdraw from the audit are::

1. Concerns about the integrity of management or withholding of evidence raised during the audit.
2. The client refuses to justify material misstatements in the financial statements.
3. The client did not take appropriate steps to correct fraud or illegal acts discovered during the audit.

In every audit assignment, the audit planning stage is very important for the CPA in deciding whether to accept or reject the engagement. Increasing cases of lawsuits (litigation) against CPAs and intense competition require CPAs to formulate quality control policies and procedures to determine whether engagements from clients will be accepted or continued to

minimize the possibility of a relationship with a client whose management lacks integrity according to SPM Section 200 (Wondabio, 2006:25).

The hypothesis of this research is determined as follows:

H1 : There is a positive influence of audit risk and audit engagement acceptance.

H2: There is a positive influence of independence and the audit engagement acceptance.

H3 : There is a positive influence of CPA's business risk on the the audit engagement acceptance.

H4 : There is a positive influence of the client's business risk on the the audit engagement acceptance.

H5 : There is a positive influence of all the external variables on the the audit engagement acceptance.

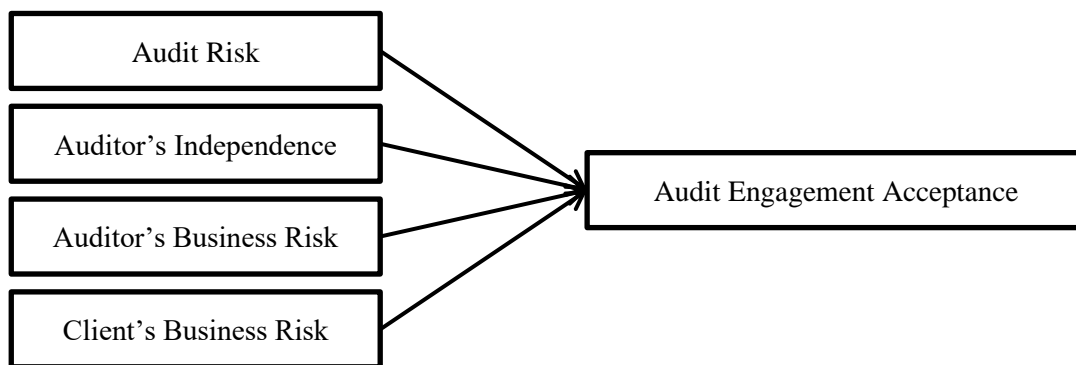


Figure 1. Research Conceptual Framework

RESEARCH METHODS

This quantitative research is based on the philosophy of positivism which is used to examine certain populations or samples, data collection using research instruments, data analysis is quantitative or statistical, with the aim of testing the established hypotheses (Sugiyono, 2017:8).

The population in this study are CPA partners in the Surabaya area who are registered in the 2019 Directory of the Indonesian Institute of Certified Public Accountants (IAPI), where there are 42 CPAs with 97 CPA partners in Surabaya. The sample of this research is various authorities in CPA (owner, partner or manager). Simple Random Sampling technique is used in research to take sample members from the population which is carried out randomly without regard to the strata that exist in the population (Sugiyono, 2012: 93). Determination of the research sample is done by drawing lots until it is evenly distributed, then the appropriate sample is taken. The sample

required is 78 auditors.

The analytical technique used is descriptive and inferential statistical analysis with Structural Equation Model (SEM) using the SmartPLS 3.0 program. The partial correlations between the exogenous variables and the endogenous variable will be tested with the t-test while the simultaneous correlation between all the exogenous variables and the endogenous variable will be tested via F-test.

The research variables and their measurements are described in the following table:

Tabel 1 Research’s Variables and Indicators

Variables	Variables Name	Indicators
X ₁	Audit Risk (Wondabio, 2006; Weningtyas <i>et.al</i> , 2006)	Evaluation of the company's internal control system
		Transaction volume remaining at the end of the year
		Restrictions on obtaining data by company management
		Fraud in the presentation of financial statement data
X ₂	Independence (Trisnaningsih, 2007)	Free from any requirements for audit assignments outside the requirements of the audit process.
		Free access to all records, asset checks, and employees relevant to the audit conducted.
		Free from all managerial restraints in the examination of activities or in obtaining evidence.
		Free from personal interests that hinder audit verification.
		Free from pressure to not report significant matters in the audit report.
		Avoiding the use of misleading words -intentionally or unintentionally- in reporting facts, opinions, and recommendations in the auditor's interpretation.
X ₃	CPA Business Risk Wondabio (2006)	Lawsuits by the aggrieved party
		Auditor’s financial risk
		Professional organization risk
		Psychological impact of negative publicity
		Public accusations of CPA's reputation
		Audit professionalism
X ₄	Client Risk (Wondabio, 2006; IAI 2001 SA. Section 315)	Client management integrity
		Client's business conditions
		Client's financial condition
		Legal identification with respect to the main product produced
		Client industry
		Evaluating capability systems for audits
Y	Audit Acceptance Decision (Wondabio, 2006; Weningtyas <i>et.al</i> , 2006)	Accepting engagements with prospective clients with low risk potential based on an assessment of risk management
		Formulate quality policies and procedures in the decision to accept or reject the audit engagement
		Perform audit planning in the decision to accept or reject the audit engagement

RESLUTS AND DISCUSSIONS

Validity test

The validity test reveals all 24 questions, with reference to the formula $df = n - 2$ gives the

result that all items in each indicator have a value of $r \text{ count} > r \text{ table}$, this is in accordance with the determined provisions, then it states that the results of the audit risk variable validity test, independence, auditor's business risk and client's business risk are declared valid and can be used in research.

Reliability test

Based on the reliability test, it was revealed that all statement items had a value > 0.60 , meaning that the statement items from all variables were declared reliable and could be used in this study.

Multiple Linear Regression Analysis

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	-4.873	1.014		-4.808	.000
Audit Risk	.211	.070	.291	3.026	.003
Auditor's Independence	.139	.046	.261	3.001	.004
Auditor Business Risk	.097	.053	.179	1.841	.070
Client's Business Risk	.125	.044	.267	2.818	.006

a. Dependent Variable: Audit Engagement Acceptance

The value of the regression coefficient of Audit Risk from the calculation of the multiple value is positive 0.211, which means that if the Audit Risk increases by 1%, the Audit Engagement Decision will increase by 0.211%.

Auditor Independence regression coefficient value from the calculation of multiple values is positive 0.139, which means that if Auditor Independence increases by 1%, the Audit Engagement Decision will increase by 0.139%.

The CPA Business Risk regression coefficient value from the multiple value calculation is positive 0.097, which means that if the CPA Business Risk increases by 1%, the Audit Engagement Decision will increase by 0.097%.

The value of the Client Business Risk regression coefficient from the multiple value calculation is 0.125, which means that if the Client's Business Risk increases by 1%, the Audit Engagement Decision will increase by 0.125%.

t-Test

This test tests how much influence one independent variable has on the dependent variable

assuming the other independent variables are constant. The t test is used to see the relationship between the X variable partially and the Y variable.

Hypothesis	Correlations		<i>standardized coefficient</i>	<i>Sig-value</i>	<i>*Sig.Crit</i>	<i>Keputusan*</i>
H1	RA	→	0.070	0.003	0.05	Significant
H2	IA	→	0.046	0.004	0.05	Significant
H3	RBKAP	→	0.053	0.070	0.05	Insignificant
H4	RBKLI	→	0.044	0.006	0.05	Significant

Notes: *significantat 0,05 = 5%

Testing Hypothesis 1. The effect of audit risk on audit engagement decisions shows the standardized coefficient value of 0.070 and sig-value of 0.003, so it is stated that H1 is accepted and has a significant effect. Based on respondents' responses regarding audit risk, 59% of respondents agreed that they should consider the internal control system regarding the company's standard operating procedures (SOP) in each division. This is in accordance with the results of testing respondents' responses related to the Acceptance Decision which showed 30% agreed that the acceptance of engagements with clients with low risk potential based on an assessment of risk management.

Testing Hypothesis 2. The effect of Auditor Independence on Audit Engagement Decisions shows the results of a positive standardized coefficient value of 0.046 and a sig-value of 0.004, then H2 and has a significant effect. The results of respondents' responses related to auditor independence showed that 60.3% of respondents agreed that direct and free examination of all books, records, officials and employees of the company related to activities, obligations and business resources, in accordance with the test results. Respondents' responses related to the Audit Acceptance Decision showed 50% agreed that they carried out the audit planning stage in accepting or rejecting the audit engagement.

Testing Hypothesis 3. The results of testing the influence of CPA Business Risk on Audit Engagement Decisions get a positive standardized coefficient value of 0.053 and a sig-value of 0.070, so it is stated that H3 is rejected, meaning that the influence of CPA Business Risk on Audit Engagement Decisions is not proven to have a significant effect. The results of respondents' responses related to audit risk showed that 55.1% of respondents agreed that taking into account the financial risks of professional practice, according to respondents' responses related to audit acceptance decisions, 30% stated that they agreed that the acceptance of engagements with clients with low risks potential based on the assessment would risk management.

Testing Hypothesis 4. Based on the results of the test in the table above, the influence of Client's Business Risk on Audit Engagement Decisions shows a positive standardized coefficient value of 0.044 and a sig-value of 0.006, so H4 is accepted and has a significant effect. The results of respondents' responses related to audit risk indicate that 65% of respondents strongly agree that confirming with parties who have business relationships with prospective clients to obtain management integrity. This is in accordance with the test of respondents' responses related to the Audit Acceptance Decision, which shows 30% agree that the acceptance of engagements with clients with low risks potential is based on an assessment of risk management.

F Test

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	145.067	4	36.267	44.181	.000 ^b
	Residual	59.923	73	.821		
	Total	204.990	77			

a. Dependent Variable: Audit Engagement Acceptance

b. Predictors: (Constant), Client's Business Risk, AuditorIndependence, AuditRisk, Auditor's Business Risk

The results of the F test using SmartPLS 3.0 show the results that the feasibility of the model has a value of $0.000 < 0.05$ (Significant level), it suggests that the influence of the variables Audit Risk, Auditor Independence, CPA Business Risk and Client Business Risk together has a significant influence on Audit Engagement Decisions.

CONCLUSION

From the results of the research analysis, it is concluded that it indicates that:

1. Public Auditors in Surabaya always consider risk management for audit acceptance decisions by providing an assessment of internal control.
2. Public Auditors in Surabaya always prioritize independence by conducting direct and free examinations without pressure from anyone in making audit acceptance decisions.
3. The Auditor's Business Risk does not affect the audit engagement decision, meaning that each CPA prefers to work for a company that is in accordance with the size of the CPA's provisions or with long-standing clients, so that this makes KAP less exposed to external risks.
4. Public Auditors in Surabaya always consider the client's business risks for making audit

acceptance decisions by evaluating the company's financial condition. It is important for the auditor to understand the client's business risks, as these risks are inherent to the client. If the client is experiencing financial difficulties, going concern problems or legal problems, and the party who feels aggrieved has a reason to demand the reliability of the financial statements, the lawsuit may involve the auditor, including the relevant CPA. Therefore, before deciding whether to accept or reject an engagement, a CPA must consider the client's risks, both directly and indirectly, that may affect the CPA's business risks. The higher the client's business risk, the less likely the client will be accepted.

IMPLICATIONS

The implications of the research results include theoretical and practical implications. On the theoretical basis, the results of this study indicate that it is important to analyze risk management in decision making on audit engagement acceptance. Therefore participation in accounting education (especially auditing) to develop about risk management. While on the practical side, the results of this study have implications for CPA owners in terms of decision making and as a tool to sharpen the analysis of risk management in making decisions about acceptance of audit engagements.

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