

An Empirical Study of Independence from Auditors in Padang, Indonesia

Charoline Cheisviyanny¹, Sany Dwita², Herlina Helmy³, Fefri Indra Arza⁴

¹Universitas Negeri Padang, Padang, Indonesia ✉ charoline.cheisviyanny@gmail.com

²Universitas Negeri Padang, Padang, Indonesia ✉ sany@fe.unp.ac.id/sanydwita@gmail.com

³Universitas Negeri Padang, Padang, Indonesia ✉ lynnherlin@gmail.com

⁴Universitas Negeri Padang, Padang, Indonesia ✉ fefriarza@gmail.com

Abstract

This research aims to prove the independence among auditors in private and public sector in Padang, West Sumatera, Indonesia. The population is all auditors in Padang, consists of auditors in private sector (internal auditors and public accountants) and auditors in public sector (auditors of inspectorate and BPK). There are 75 respondents in private sector and 79 respondents in public sector. The results show (1) in private sector, there is no significant different of independence between external and internal auditors and (2) in public sector, external auditors tends to be more independence than internal auditors. It implies that instead of auditors themselves, support from top management or legislative is also needed to enhance the independence of auditors.

Keywords: *independence, internal auditor, public accountant, BPK, inspectorate*

Introduction

In the second audit standard (Arens et al, 2017) it is stated that the auditor must maintain an independent mental attitude in all matters relating to the audit. This standard requires the auditor to be independent, because the auditor carries out his work in the public interest. Thus the auditor is not justified to take sides. The auditor must carry out the obligation to be honest not only to the management and owner of the company, but also to all users of the audit report. This principle should be implemented by both internal auditors and external auditors.

In private sector, internal auditors are auditors who work in companies, while external auditors are auditors who work in public accounting firms. On the otherhand, in public sector, internal auditors are called *Aparat Pengawasan Fungsional Pemerintah* (government functional supervisory agency) conducted by the *Badan Pengawasan Keuangan dan Pembangunan* (Financial and Development Supervisory Agency), Inspectorate, and *Badan Pengawasan Daerah* (Regional Oversight Agency) and external auditors are auditors who work for the *Badan Pemeriksa Keuangan* (BPK/Indonesian Audit Board) and responsible to the legislative.

The Institute of Internal Auditors Professional Practices Framework (Arens et al, 2017) states "*Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes*". Arens et al (2017) defines internal auditors as auditors employed by a company to audit for the company's board of directors and management, while external auditor are certified public accountants or accounting firms that perform audits of commercial and non commercial entities.

There are at least 4 factors that distinguish these internal auditors and external auditors, namely: (1) Output factors, where the main output of an external audit is opinion while the main output of the internal auditor is a recommendation (2) Independence, where the external audit is independent of the activity being audited while internal audit must be independent of management (3) client factors, clients of external audit are shareholders, commissioners and related parties outside the company while clients of internal audit are management themselves (4) reporting factors where the external audit reports the results of the audit to stakeholders while the internal audit report the results of audits to the directors / management.

Basically, if internal auditors and external auditors are equally adherent to the guidelines that bind their attitudes and seriously implement these guidelines in their performance then there will be no degree of independence difference between internal auditors and external auditors. But in practice internal auditors are more vulnerable to being less independent when compared to external auditors, this is due to differences in the scope of work in terms of output, where the work of external auditors is assessed and published to many parties such as shareholders, commissioners and parties related outside the company while the work of internal auditors is only known by the company's management itself, then in terms of independent responsibility, in terms of clients faced and in terms of reporting. Arens (2017: 39) states that internal auditors cannot be entirely independent of the entity as long as an employer-employee relationship exists. Users from outside the entity are unlikely to want to rely on information verified solely by internal auditors because of their lack of independence. So it will be more difficult for internal auditors to maintain their independent attitude when compared to external auditors.

This research wants to conduct a independence test on internal and external auditors in Padang. We divide auditors into two groups: auditors in private sector and auditors in public sector. Auditors in private sector consist of internal auditors in companies and public accountant. Auditors in public sector consist of auditors of inspectorate as internal auditors and auditors of BPK as external auditors. This research will use the TPB (Ajzen, 1991) as grand theory and the MEM as the measurement of independence (Patel, 2003). Reidenbach and Robin (1990, 1998) as cited by Patel (2003) stated that ethical evaluation and ethical intention of accountant should be measured by using Multidimensional Ethics Measure (MEM). MEM consists of three dimensions: (1) Moral Equity, which is about what is just/unjust, fair/unfair and morally right/wrong in human behavior, (2) Relativisme, which consists of cultural acceptable/unacceptable and traditionally accepted/unacceptable, dan (3) Contractualism, which consists of violating/not an unwritten contract and violating/not an unspoken promise.

This study refers to researches conducted by Gendron et al (2006), Spanhove et al (2008), and Christopher et al (2009). Gendron et al (2006) found that auditors who worked in public accounting firms (external auditors) had less independence than auditors who did not work in public accounting firms (internal auditors). Spanhove et al (2008) found clear differences in the professionalization of internal audit functions at different levels. The independence of internal audit in the public sector is linked to the reporting line and the existence of the audit committee. Christopher et al (2009) found that the relationship between the internal audit, management and audit committee functions could threaten the independence of an auditor.

Based on above explanations, the research question is whether there are differences in independence between internal and external auditors both in the private sector and in the public sector?

Hypothesis Development

External auditors and internal auditors are both bound in the code of conduct when doing their work, one of which where external auditors and internal auditors are required to maintain their independence. In a study conducted by Gendron et al (2006) they found that the independence commitment of auditors working in public accounting firms was lower than accountants who did not work in public accounting firms. The tight competition between public accounting firms also causes auditors to try to keep their clients using their services. But KAP competition also makes auditors tend to behave according to client desires when the level of termination of employment with the KAP if the auditor is not willing to comply with the client's wishes relatively high (Nichols and Price, 1976 in Rimawati, 2011). In Elfarini's (2007) research, it is stated that public accountants will be disrupted if they have a business, financial and management relationship or employees with their clients.

Sukrisno (2014) states that the public accounting profession throughout the world is a profession that faces a very high risk. Almost all public accountants realize that they must provide professional services in accordance with SPAP, comply with the public accountant's code of ethics and have quality control standards. If not, the public accountant can be wrong in giving the WTP opinion even though the financial

statements contain material misstatements. And this certainly can adversely affect external auditors, they will be threatened with criminal sanctions, fined and even their KAP efforts will be frozen by the authorities. Realizing this, of course they will be careful in their actions and try not to violate the code of ethics that has been bound.

While the internal audit is carried out by the company's own employees (people in the company), many parties assume that the internal auditor is not independent. In the classification of differences between internal auditors and external auditors, it is stated that outside parties of the company assume that internal auditors are not independent (in-appearance) and external auditors are those who are considered more independent.

Arens (2017) states that the responsibilities and conduct of audits by internal and external auditors differ in one important respect. Internal auditors are responsible to management and the board of directors, while external auditors are responsible to financial statement users who rely on the auditor to add credibility to their financial statements, so this causes the internal auditor to have a higher independence dilemma when compared to external auditors. Independence is rarely a problem for external auditors because they are not employed by the companies they audit.

In general, internal auditors are said to be independent if they can carry out their duties freely and objectively. On the other hand, internal auditors face many problems and conditions that confront them to risk their independence. As an employee or worker of an organization, the internal auditor earns income from the organization where he works, this means that the internal auditor depends on his organization as an employer. Internal auditor independence will be influenced by consideration of the extent to which the results of the internal audit will have an impact on the continuity of his work as an employee. So, the hypothesis of this research are:

H1. Public accountants are more independence than internal auditors

H2. BPK Auditors are more independence than inspectorate auditors

Methods

This study is a comparative research. The population is auditors in private sector and public sector, which consists of internal auditors and external auditors. We use total sampling method because the population is less than 100 auditors in each cluster. In private sector, the respondents are internal auditors in some private companies and public accountants as external auditors. In public sector, the respondents are auditors in inspectorate as internal auditors and auditors in BPK as external auditors.

The instrument will be measured by using a case referred from Patel (2003) using a likert scale 1-7. There are two different types of cases for auditors in private sector and in public sector, but in a same context about independence. Respondents were asked to evaluate the auditor's actions through seven scales from next to question:

Three respondents' questions were asked to evaluate actions and terms:

1. Do they see it as an ethical and unethical point of view (Q1)
2. Will they make the same decisions as auditors in the scenario (Q10)
3. Will their peers make the same decisions (Q11)

The other eight questions consist of items in Reidenbach and Robin (1988, 1990) in Patel (2003) MEM sizes. MEM consists of four dimensions:

1. Arranged in the order of their theoretical interests which are fair /unjust, morally/morally untrue and acceptable/unacceptable to my family (Q2-Q5).
2. The dimension of relativism consists of two items where culture is accepted / culturally unacceptable (Q6 and Q7).
3. The dimension of conceptualism consists of two items which do not violate the written contract/ breach of written contract and do not violate the contract mentioned / breach the contract mentioned (Q8 and Q9).

The analysis technique used in this study used the average difference test with independent test of t-test sample. The test criteria are:

1. If $t_{stat} < t_{table}$ H1 is rejected
2. If $t_{stat} \geq t_{table}$ H1 accepted.

Results and Discussion

The respondent of this research are auditors in private sector and in public sector. Here is the demography data of respondent:

Table 1. Respondents Demography

	Private Sector						Public Sector					
	Public Accountant		Internal Auditor		Total		BPK (external)		Inspektorat (internal)		Total	
Gender:												
Female	17	45%	22	59%	39	52%	14	36%	13	33%	27	34%
Male	21	55%	15	41%	36	48%	25	64%	27	67%	54	66%
	38		37		75		39		40		79	
Age:												
22-25 yo	18	48%	7	19%	25	34%	-	0%	-	0%	-	0%
26-35 yo	13	34%	18	49%	31	41%	17	44%	6	15%	23	29%
36-54 yo	7	18%	12	32%	19	25%	14	36%	21	53%	35	44%
>55 yo	-	0%	-	0%	-	0%	8	20%	13	32%	21	27%
	38		37		75		39		40		79	
Education												
Diploma	3	8%	6	16%	9	12%	-	0%	1	2%	1	1%
Bachelor	34	89%	26	70%	60	80%	38	97%	35	88%	73	93%
Master	1	3%	5	14%	6	8%	1	3%	4	10%	5	6%
	38		37		75		39		40		79	

Table 1 shows the demography of respondents. In private sector, most of respondents are female (52%), are 26-35 years old (41%), have bachelor degree (80%). The respondents in public sector mostly are male (66%), are 36-54 years old (44%), and have bachelor degree (93%).

H1. Public accountants are more independence than internal auditors

The following tables show the results of data processing for H1:

Table 2. Result for H1

		Std Dev	Mean	t	sig
Public accountants	n1=38	13.76	61.29	-0.852	0.397
Internal Auditors	n2=37	8.76	63.57		

The table shows the results test of H1 with sig 0.397 > 0.05, it means there is no significant difference between public accountants as external auditors and internal auditors. When viewed from the mean value, internal auditors (63.57) slightly tend to be independent than external auditors (61.29).

The results of this study are not in line with the research of Gendron et al (2006), but in line with the research of Hazami-Ammar (2015), which states that the independence of internal auditors is built according to a particular context which means the presence or absence of an audit committee will remain an internal auditor's independence which is due to the relationship between the audit committee and internal audit in a

hierarchical position and the internal audit function to remain able to be independent must be able to overcome several conflicts of interest. Support from all management and the board of commissioners can assist internal auditors in carrying out their duties independently (Elfarini, 2007).

The role of the audit committee in maintaining independence is also stated by Arens et al (2017). OJK rules that require all public companies to have an audit committee tasked with selecting and overseeing the work of auditors are believed by Arens et al (2017) to increase auditor independence. So besides the independence of the auditor itself, the role of top management and the audit committee is also needed to keep the auditor remaining independent.

H2. BPK Auditors are more independence than inspectorate auditors

The following tables show the results of data processing for H2:

Table 3. Result for H2

		Std Dev	Mean	t	sig
Auditors of BPK	n1=39	5.49	68.74	4.238	0.001
Auditors of inspectorate	n2=40	12.57	59.45		

The table shows the results test of H2 with sig $0.001 < 0.05$, it means there is a significant difference between BPK and Inspectorate. When viewed from the mean value, auditors of BPK (68.74) are more independence than auditors of Inspectorate (59.45).

Lack of independence from the government's internal auditors can reduce the quality of internal audits. This is evidenced by the results of Astrawan's study (2015) which found that many audit findings were not detected by the Inspectorate apparatus as Internal auditors, but were found by the BPK, where the average findings from the BPK during 2009 to 2013 were greater than the findings Klungkung Regency Inspectorate. This means that the inspection quality of the Klungkung Regency Inspectorate apparatus is still relatively low compared to the inspection results from BPK.

If in the private sector there are top management and audit committee that maintain auditor independence, the role of regional and legislative heads in the public sector may still be lacking so as not to be able to increase the independence of the inspectorate auditors. The results of this study should be used to enhance the role of regional heads and legislators in maintaining auditor independence in the public sector, particularly the government's internal auditors.

The results of this study imply that there are different conditions between auditors in the private sector and auditors in the public sector. In the private sector, external auditors rely on internal auditors when using the audit risk model to assess risk control. If internal auditors are effective, the external auditors may reduce their fees substantially because a highly regarded internal audit function can significantly reduce control risk, and thus reduce substantive testing. Auditing standards also permit the external auditors to use the internal auditors for direct assistance on the audit. When internal auditors provide direct assistance, the external auditor should assess their competence and objectivity and supervise and evaluate their work (Arens al al, 2017). This mutual relationship pushes the auditors to keep their independence and audit quality. Maybe this is not yet fully implemented in the public sector so that there is a difference in independence between the BPK auditorss and the inspectorate auditor.

It must be realized that external auditors and internal auditors have different goals, responsibilities and qualifications and work in different activities. But they both have a code of ethics that binds their profession, one of which is to maintain their independence in professional activities. Both external auditors and internal auditors are often faced with a dilemma of conflict. On one hand the auditor must comply with audit standards in which the auditor must be independent and impartial to any party, but on the other hand the auditor also has a self-interest attitude or personal desire to meet his personal needs which can certainly threaten the level of professionalism and independence. For this reason, all parties must understand their role so that the independence of the auditor can be maintained.

Conclusion and Suggestion

Conclusion

Based on the analysis in the previous section, it concluded that:

1. There is no significant difference on independence between public accountants and internal auditors.
2. Auditors of BPK are more independence than auditor of inspectorate.

Suggestion

Based on the explanation above, it is suggested to explore why internal governmental auditors is less independence than external governmental auditors. This finding can give information for government to enhance the independence of governmental auditors in order to enhance the audit quality of financial statements.

References

- Ajzen, Icek. (1991). *The Theory of Planned Behaviour*. Organizational Behaviour and Human Decision Processes, pp 179-211.
- Arens, A. Alvin, Ellder J. Ronal & Beasley Mark S. (2017). *Auditing dan Assurance Services*. Sixteenth Edition. England: Pearson Education Limited.
- Astrawan, I Kadek Yogi. (2015). *Etika Memoderasi Pengaruh Kompetensi, Pengalaman dan Independensi pada Kualitas Hasil Pemeriksaan Inspektorat Kabupaten Klungkung*. S1 Thesis. Universitas Udayana Denpasar.
- Christoper, et al. (2009). A Critical Analysis of the Independence of the Internal Audit Function : Evidence From Australia. *Journal Accounting, Auditing and Accountability*. Vol 22 no. 2 pp. 200-220.
- Elfardini, Eunike Christina. (2007). *Pengaruh Kompetensi dan Independensi Auditor Terhadap Kualitas Audit*. S1 Thesis. Universitas Negeri Semarang.
- Gendron Yves, Suddaby Roy dan Lam Helen. (2006). An Examination of the Ethical Commitment of Professional Accountants to Auditor Independence. *Journal of Bussiness Ethics*, Vol 64 No.2.
- Hazami–Ammar. (2015). Critical Analysis of Internal Audit Independence : International Literature. *Journal Of Research In Business, Economic And Management*, Vol 3, Issue 3.
- Hudaib, Haniffa. (2009). Exploring Auditor Independence: An Interpretive Approach. *Accounting, Auditing, and Accountability Journal*. Vol 22 No 2.
- Ikatan Akuntansi Indonesia (IAI). (2001). *Standar Professional Akuntan Publik*. Jakarta: Salemba Empat.
- Patel, Chris, Graeme L. Harrison dan Jill L. McKinnon. (2002). Cultural Influences on Judgments of Professional Accountants in Auditor-Client Conflict Resolution. Vol 13. Macquire University. Sydney: Australia.
- Patel, Chris. (2003). Some Cross-Cultral Evidence on Whistleblowing as an Internal Control Mechanism. *Journal of International Accounting Research*. Vol. 2. 2003.
- Rimawati, Nike. (2011). *Faktor–Faktor Yang Mempengaruhi Independensi Auditor*. S1 Thesis. Universitas Diponegoro Semarang.
- Spanhove Jurgen et al. (2008). Internal Audit as A New Instrument of “Government Governance” An Analysis of Internal Audit Activities and The Independent Position within The Belgian Public Sector. *Proceeding of 5th International Conference on Accounting, Auditing & Management in Public Sector Reforms*, EIASM, Amsterdam, September 3-5, 2008.
- Sukrisno, Agoes. (2014). *Auditing Petunjuk Praktis Pemeriksaan Akuntan Oleh Akuntan Publik*. Jakarta: Salemba Empat.