

Factors Affecting the Auditor's Independence: Referring to the Provision of Management Advisory Services

(Case Study on 4 Certified Public Accountant in Malang City)

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Abstract :

The development of CPAs nowadays affects the needs of audit service of clients. They cannot be separated from the role of auditors. Therefore, auditors must be independent in doing their job, including MAS (Management Advisory Service) to improve the quality of their service. The provision of this service can cause auditors to work outside the standard and professional code of ethics that will harm concerned parties. The objective of this research is to get accurate information about factors that affect the independency of auditors during the provision of MAS. Based on past events, independency of auditors becomes the attention of people, particularly in this time, so many criminal cases caused by the auditor's that can be relieve the client's trust. The technique of data gathering of this minor thesis is interview technique carried out with four CPAs registered in Malang, represented by one auditor each. The result of this study showed that the excessive knowledge of auditors about clients affected the independency of auditors in providing MAS. The aspect of auditors' knowledge about clients directly related to data gathering process by auditors through interview and direct sharing. Thus, the intensity of communication between both parties increased the chance for auditor as professionals to work astray from standards and professional code of ethics.

Keywords: *Auditor Independency, Management Advisory Service, Emotional Relationship, Auditor Responsibility and Ethical code of Accounting Professions*

Background:

The role of auditors is essential in determining the success of fair presentation of financial statements. This to answer two different requirements of company's management, which is to present fair financial statements of a certain period, and the interests of external factors or users, which require reliable and trustworthy financial statements as cornerstones in their decisions. Lee (1993), Damayanti and Sudarma (2007) stated that auditors are independent party that mediates these two interests (agent and principal) who provide audit opinions on the financial statements to determine reasonableness. Based on the previous studies, the author took management advisory services as the discussion of this thesis. This is because the provisions of management advisory services to clients have negative effects that affect the independence of auditors in achieving professionalism in their job. On the other hand, the

author attempts to associate with some of the rules contained in the standard statement of consulting services as well as the foundation and limitations of auditors in consulting services. Standards Advisory Services is a guide for practitioners (CPAs) that provides consulting services to clients through a public accounting firm. In consulting services, practitioners present the findings, conclusions, and recommendations. Of the various explanations of a wide advisory service described above, researchers can consider carefully about what are the size and boundaries of an auditor in providing management advisory services to clients to keep working within the principle of independence. The author conducted this study to identify factors that may affect the independence of auditors, especially in the provision of advisory services used as a reference in providing these services

1.2 Research Questions

What factors that are likely influence the independence of an auditor when they provide non-audit services such as Management Advisory Services (MAS) to clients in 4 Certified Public Accountant in Malang City?

1.3 Research Objectives

The purpose of this study is to review the factors that affect the independency of auditors in providing management advisory services to clients in 4 Certified Public Accountant in Malang City.

LITERATURE REVIEW:

2.1. Previous Research

Several studies have tried to find any relationship between these factors and the independence of auditor, whether it is significant or not related, associated positively or negatively (Pany and Reckers, 1980). The other group tried to make ranks of degree of influence on the perception of auditor independence (Shockley, 1981; Bartlett, 1993). Among others are: (1) the effects of prize giving (Pany and Reckers, 1980); (2) provision of purchase prices (Pany and Reckers, 1980); (3) the size of public accounting firm (KAP) (Shockley, 1981); (4) the provision of management advisory services (MAS) (Shockley, 1981; Knapp, 1985; Bartlett, 1993; Teoh and Lim, 1996); (5) the financial condition of the client (Knapp, 1985); (6) causes of conflict (Knapp, 1985); (7) the length of the audit (Shockley, 1981; Teoh and Lim, 1996); (8) the level of competition in providing auditing services (Knapp, 1985); (9) the amount of audit services compared to the size of the client (Bartlett, 1993; Teoh and Lim, 1996; Pany and Reckers, 1980); (10) the existence of audit committee (Teoh and Lim, 1996).

2.2 Management Advisory Service (MAS)

Management consulting services or management advisory services (MAS) is an advisory function to provide advice and technical assistance to increase the use of the capability and resources to achieve the goal of the client's company. Accountants can be contracted to give an opinion as an expert on a particular issue such as the use of accounting principles, tax

laws, and the use of technology processing for financial data. Public accountant, with its capacity as a consultant, is not justified making or determining managerial decisions. Consulting services differ essentially from public accountant attestation services to third parties assertions. In attestation services, practitioners provide a conclusion about the reliability of a written assertion that is the responsibility of the other party, namely the assertion maker (asserter). In consulting services, practitioners present the findings, conclusions, and recommendations. The nature and scope of consulting services are determined by agreement between the practitioner and the client. Generally, consulting services are performed for the benefit of clients.

2.3 Factors Affecting Auditor Independence

As mentioned in the research of Nur Barizah Abu Bakr et al. (2005), there are at least six factors on the perception of auditor independence investigated by previous studies. They are the size of public accounting firms, the level of competition in the market to provide auditing services to clients, the length of the audit relationship in serving the needs of the client, the cost of audit services paid by the client to the public accounting firm, privileged form of managerial advice by public accounting firms to clients, and the presence of audit committee on an increasingly extensive client company. The study concluded that the high level of interest that connects officers dealing with commercial lending bank to the audit report could be distributed into their perspective on auditor independence. It is no doubt that the audit report is very useful and important as a basis for deciding a loan. Therefore, there is a strong relationship between usability audit reports with auditor independence.

Some empirical survey was conducted to determine how the third party, the auditor, and the company see this. However, the result is still debatable and cannot be concluded (Goldman and Barlev, 1974). McKinley et al. (1985) reported that the beginning of the research related to the use of the financial statements indicates that the auditor independence is negatively affected by additional services in the form of advice given to clients. They believe that this kind of additional services will create a working relationship between the auditor and the client that is too close. As with the study conducted by Shockley (1981); Pany and Reckers (1983, 1984) and Knapp (1985), MAS negatively affects the perception of auditor's independence. Reckers and Stagliano (1981) concluded that the loss of confidence of the external auditors will increase significantly if the non-audit fee paid to the auditor exceeds 50 percent of the audit services cost. On the contrary, other studies found different things (Wallman, 1996). According Golman and Barlev (1974), which supports this point of view, the addition of services to the management company will increase the strength and the independence of auditors. Based on this different condition, MAS will influence the independence when someone can't be defend their integrity in order to separated of professionals service giving and also the conversely

2.4 Professional Ethic

The word ethics is derived from ethikos, which means "arising from habit". Ethics is a major branch of philosophy that studies the value or quality of moral standards and assessment. Ethics covers the analysis and application of concepts such as right, wrong, good, bad, and responsibility. Ethics is divided into three main parts: a meta-ethics (the study of the concept of ethics), normative ethics (the study of the determination of the value of ethics), and applied ethics (the study of the use of ethical values).

2.5 Qualitative Characteristics

a. Relevant

Relevant means the provision of management services and advisory service have a special dependency on the interests of an auditor in accomplishing his tasks and in providing an opinion.

b. Reliable

Reliable means that the information given by an auditor to the client in terms of management advisory service is completely free of any fraud caused by the close relationship between the auditor and the client.

c. Comparable

The opinion a management consulting services can be easily compared with the opinion of other consulting services for the sake of accuracy.

d. Understandable

The opinion issued by the auditor must not generate bias, or it is easily understood by report readers.

2.6 The Importance of Independence

According to the Rules of Ethics , in carrying out their duties, members of the firm must maintain an independent mental attitude in providing professional services, as stipulated in the professional standards set by IAI's public accountant. The independent mental attitude should include independent in fact and in appearance.

According Aren (2006: 84), independence is an impartial perspective in the implementation of evaluation test from the examination results, and preparation of audit reports. From those conclusions, it can be drawn a conclusion that the definition of public accountant independence is mind and mental attitude of public accountants and experts of being free from persuasion, influence, and control of other parties in the planning, assessment, and reporting of test results.

RESEARCH METHOD

3.1 Type of Research

The researcher concluded the type of case studies used in this study is instrumental case study. This is because the researcher seeks to provide an understanding and explanation of the case that has been studied before, but packed with a more detailed and in-depth explanation, as well as present different objects that have been studied previously.

The purpose of this study is to determine the factors that affect the independence of auditor that simultaneously provides management advisory services to clients. With these objectives, the type of research is descriptive research. This refers to Indriantoro and Supomo (1999: 80), which stated that the study was a descriptive study of phenomena or certain populations from subjects such as individual, organizational, industry and other perspectives. Further, descriptive based research also aims to study the aspects of whom, what, when, and how in a topic.

3.2 Research respondent

No.	Name of CPA Office	Respondent
1	Made Sudarma, Thomas & Dewi (Jl. Dorowati No.8, Kota Malang 65119)	1
2	Drs. Nasikin (Jl. Semeru, Kota Malang)	1
3	Drs. Suprihadi & Rekan (Jl. Bunga Andong Slt Kav 26 Perum Simpang Soekarno Hatta, Kota Malang 65141)	1
4	Benny, Tony, Frans & Daniel (Jl. Merbabu No.6, Kota Malang 65119)	1

3.3 Research Object

Research object of this research is to understanding the factors affecting the auditor's independence related with Management Advisory Service giving in past time by using reliable information from trustworthy respondent that determine in 4 Certified Public Accountant in Malang City.

3.4 Types and Sources of Data

a. Type of Data

This study used two data types, namely:

1. Primary Data
2. Secondary Data

b. Data source

Primary data was obtained directly from the first data source. The first data source was from interviews with one auditor in each public accounting firm. The Interviews were conducted for approximately 30 minutes. The questions were already arranged in previous concept. Secondary data were obtained from journals and literatures about independency of auditors and the provision of management advisory services. One of the secondary data is the International Journal of Business and Management Vol.4, No.2, published in February 2009 with the title of "non-audit services and audit independence: Evidence from Iran"

(www.ccsenet.org/journal.html).

3.4.1 Data Collection Techniques

To find and collect accurate and valid data, the researcher used documentation and interviews method.

a. Documentation Methods

Documentation method is done by analyzing articles and journals as a condition of the data adequacy related to the topic. The analysis is done for not only the sake of electoral but also as the primary basis of the research topic.

b. Interview Method

This study was conducted by interviewing stakeholders i.e. auditors and managers of public accounting firms, each was represented by one auditor or manager. This method was carried out to explore more accurate and valid information from the source directly, in this case the perpetrator field, so that the researcher can specifically ask for things that are personal to the respondent for the sake of data adequacy.

3.4.2 Data Analysis Techniques

In this minor thesis, the preparation method descriptive method. This method seeks to explain and describe the characteristics of the data, so that the results can give a clear picture. The data from the field observations through interviews were analyzed for the suitability with the documents that have been obtained, so the descriptive content there in may seem more objective and systematic.

The Step-by-step analyses are:

Secondary data from various journals and articles about the independence of the auditor and the provision of non-audit services that limit the authors in completing this study. After studying the data, the researcher associated the data with the conditions on the ground, so that the selection of the object of study (Public Accountant) into the next stage.

Make a field trip to four public accounting firms to crosscheck the accuracy of data from the interview.

Make tabulation to find the factors that tend to lead to the loss of independence of the auditors, especially in providing management advisory services.

Give the symbol (o) to cause that meet the criteria and (x) to which do not meet the criteria. The criteria are:

1. Emotional (personal) closeness between the client and the auditor

a. The desire to get the client auditor

b. The desire of the client to work together to manipulate the results of the audit

- c. The existence of excessive sense of responsibility of an auditor
 - d. The relationship between the auditor's debts and clients
 - e. The Clients are still family related.
2. Flexibility Management Advisory Service
- a. The notion of the audit is too risky
 - b. Management Advisory Service is more promising in terms of fees
 - c. Provision of Management Advisory Service is more flexible than audit services.
3. Knowledge of the client (information sharing)
- a. The client shares too much information about the company
 - b. The data is not related to the information needed
 - c. The auditor is responsible for the guidance given to be one of the factors determining the achievement of a client.

Provide conclusions on the main factors that tend to result in a reduction or even disappearance of the independence of the auditor in providing non-audit services such as Management Advisory Service.

DISCUSSION

1. Made Sudarma, Thomas & Dewi (M&T&D)

- The informant stated that emotional relationship between auditors and clients during the service does not affect the independence of auditors because the standard of the service provision as absolute guidance has already been set.
- The informant clearly stated that the flexibility of managerial consultation service provision does not affect the auditors' independence because it has been set in PSA Number 68. It restricts the communication between auditors and clients; so, flexibility in time of service and data presentation is eliminated.
- The excessive knowledge of auditors about clients' data that were not relevant to the companies' analytical processes was not accepted by the informant, even though, due to excessive communication, the excessive irrelevant information frequently appears. The feeling of responsibility of auditors also does not affect their independence.

2. Drs. Nasikin

- Emotional closeness did not affect the independence of auditors in Drs. Nasikin's office because the closeness was very abstract and did not represent all auditors. Emotional closeness was very personal and relied heavily on individual perceptions.
- The second aspect, the flexibility of MAS provision, did not affect auditors' attitude because if auditors assumed that way, it meant that they underestimated their

profession. Flexibility cannot be used to measure auditors' independence because auditors work based on the clients' request. Further, each specific service, either audit and non-audit service, had certain similarities and differences.

- The third aspect, auditors' knowledge about clients, was agreed by the informant to have influence on independence because the condition of data presentation and the auditors' responsibility for their clients were the determining factors. In addition, the aspect of excessive information sharing did not affect independence because the limit had been set clearly in Standard Statement of Accounting number 67 about knowledge of clients' business.

3. Benny, Tony, Frans & Daniel (BTFD)

- The aspect of emotional closeness did not affect the activity of auditors because, according to the informant, it never happened.
- The flexibility of MAS did not make any significant effect because it was influenced by the scale and the scope of clients' business. Auditors did not make any priorities in their treatment to both audit and non-audit services.
- The knowledge about clients, either professionally or personally, influenced the independence of auditors. Even though the informant had never been in the situation before, if the event had occurred, the informant's independence would have been disrupted.

4. Drs. Supriyadi & Partners

- The aspect of emotional closeness between clients and auditors did not affect auditors' independence at any level because the informant was convinced that the closeness would not likely to happen, since there was no other interest beyond the service provision between them.
- Flexibility of MAS provision, in some degrees, would affect auditors' independence because the informant assumed that the criteria of flexibility was on auditors' sole discretion and depended on the perspective, either from auditors' or clients'. Furthermore, flexibility that made closer relationship was suspected to be an ethical breach.
- The last aspect was about auditors' knowledge about clients and the condition for the independence. Auditors were expected to make approach to their clients professionally by improving their communication quality. This may cause auditors to behave dependently by dragging clients to talks that put a loss on certain parties.

Factors that affect auditor's independence in the provision of Management

Advisory Service

No.	Factors	CPA M&T&D	CPA Drs. Nasikin	CPA BTfD	CPA Drs. Supriyadi
A.	Emotional Relationship between Auditors and Client				
	1. The need of auditor to get more clients	X	x	x	x
	2. Past relationship	X	x	x	x
	3. Excessive sense of responsibility	O	o	x	x
	4. Debts relationship	X	x	x	x
	5. Family relationship	X	x	x	x
B.	Management Advisory Service Flexibility				
	1. Assumption that audit is too risky	X	x	x	o
	2. Fee for MAS is bigger	X	x	x	x
	3. MAS provision is more communicative and friendly	O	x	o	o
C.	Knowledge about Client				
	1. Excessive information	X	x	o	o
	2. Irrelevant data	X	o	o	o
	3. Auditor's determine the clients achievement	O	o	x	x

CONCLUSIONS AND SUGGESTIONS

5.1. Conclusions

Based on the result of analysis, the excessive knowledge of auditors about clients has the strong effect on the independence of auditors during their MAS provision in four CPAs in Malang (M&T&D, Drs. Nasikin, BTfD, and Supriyadi & Partners). Most informants explained that the aspect of auditors' knowledge about clients was directly related to data gathering through interview and data sharing, so the chance for auditors to break the rules was big.

5.2. Research limitations

During the study on the four CPAs in Malang, the study had had several limitations in the field observation. Those were caused by:

- a. Several CPAs could not give complete and detailed information as expected by the author. This was because the topic dealt with the most fundamental issue for auditors, i.e. independence. Therefore, the informants revealed general view instead of personal and detailed matters since they affect the reputation of the CPAs.
- b. The little time available for the author and informants caused limited sample and interview duration. Auditors from each CPAs were very busy and had fixed schedules.
- c. The last limitations is about the total respondents in this research that are in even number (4 respondent), this condition cause a problematic situation to determine or conclude the result of data analysis, so better if the researcher selecting a respondent in odd number to make easier in data processing.

5.3. Suggestions

In spite of the limitation above, this study is expected to be beneficial for all related parties in the matter of factors causing the degradation of auditors' independence in MAS provision. The results showed that the excessive knowledge of auditors about clients had become the main factor of the degradation of auditor's independence.

Based on the result, conclusion, and implication of this study, the author proposed the following suggestions:

- a. For the object CPA's

The author suggested the following:

1. Improving the quality of communication with clients during the data gathering process through interview method.
2. Being aware that professional code of ethics must be attached to the auditors at anytime and anywhere, so they will feel that they are always working under supervision and not making any attempts that will disrupt their independence.
3. Identifying their clients better, so the auditors can determine their restrictions in making decision, especially in fair and clear division of obligation for both clients and auditors, so their work will not create any problem in the future.

b. For the next researchers:

1. Expanding the border of the research object, for example, by making observation on CPAs in the province of East Java, so the research result will be more accurate and detailed.
2. Improving the reference as the basis of research, such as journal and article dealing with auditors' independence in providing certain service for domestic and foreign clients.
3. The next researcher must be add the total of respondent in odd number or become 5 respondent, because it can make easier to the data processing.

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