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RESEARCH ARTICLE

Independence of Audit Ethical Decision Making Process: A Case of Indonesia

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Abstract: This study aimed to test whether there is a change in the level of independence of auditors when they are exposed to some level of work pressure related to morality and ethics, in three levels of work pressure and the threat of litigation. The study used a quasi-experimental method design with Chi-square test and regression as statistics analysis which involved professional auditors in Indonesia. The results showed that the independence of auditors who become participants in this study was not affected, despite being faced with situations that threaten their continuity in getting future assignments from the client. The auditors were still able to maintain their independence, with the attitude of conservatism and the need to maintain credibility. In addition, there are no significant differences related to the independence, of moral and ethical auditors, both when they are at a low level of work pressure, medium, or high. Since this study only uses a quasi-experimental method, further research can be developed using other research methods, such as survey methods. This research is a new research in the field of auditing and accounting ethics, especially to the context of Indonesia since the enactment of Act Number 5 Year 2011 that regulates Public Accountants.

Keywords: independence, audit ethical, decision making, Indonesia

JEL Classification: M41; M42

Among other accounting professions, independent auditors play an important role in the development of accounting. They provide assurance as well as attestation services. Furthermore, underwriting services done by a professional independent auditor improves the quality of information for decision makers. Professional accountants who perform audit must have integrity, ethics, and independence, as well as a level of adequate competence in performing their

duties. It should be a concern for audited financial statement to be mandatory for companies listed on stock exchanges throughout the country (Saidin & Osman, 2016). Ethic is defined as a science that discusses and reviews the values and moral norms. Ethics means the overall norms and judgments used by the community to find out how people should run their lives (Robbins & Judge, 2013). That is why a professional auditor sets technical standards and

ethical standards that should be used as a guide in carrying out the audit.

In 2011, the Republic Indonesia Government issued Public Accountant Act Number 5 year 2011, paragraph 1 point *e* and *f* wherein an auditor must be a public accountant that maintains competence through continuous professional training; and is well-behaved, honest, responsible, and have high integrity. Auditors and public accounting firms are also required to maintain the independence and freedom from conflicts of interest (Article 28, Paragraph 1).

Maintaining the integrity, competence, and level of independence of an auditor ²an implementation of ethics in audit procedures. Independence is the cornerstone of the audit profession and an important element of the user confidence in the financial statements. Therefore, independent auditor occupies a position of trust between management and the user of the reporting entity's financial statements. They must be considered independently of the activity on the basis of audit standards and the principles of strong ethics (Bonner, Palmrose, & Young, 1998; Chadegani, Mohamed & Jari, 2011; Falk, Lynn, Mestelman, & Shehata, 1999; Lindberg & Beck, 2002).

Literature Review

Ethics can be defined as a set of principles or moral values possessed by each person. In this case the need for ethics in society is very important, thus it is common to incorporate ethical values into the law or regulations. The ethical principles of an auditor are made up of six levels. The first of which is a sense of *responsibility*, where they must be sensitive and have moral consideration for all activities they do. Second is the *public's interest*, wherein the auditor must accept the obligation to act in such a way so as to serve the interests of the people, respect the public's trust, and show the commitment to professionalism. Third, *integrity* or the ability to maintain and broaden public confidence. Fourth is *objectivity and independence*, in which the auditor should maintain objectivity and is free from conflict of interest and should be in an independent position. Fifth, which is *due care*, whereby an auditor should always pay attention to standard techniques and professional ethics to improve the competence and quality of services, as well as carry out the responsibilities to their best ability. Lastly,

scope and nature of the services, specifically the practicing auditor for the public must pay attention to the principles of the code of professional conduct in determining the scope and nature of the services it provides.

Thus, it is clear that the auditor's attitude must be independent. The independence in audit means an impartial perspective in the implementation of testing, evaluation of test results, and preparation of audit reports. The independent mental attitude must include independence in both fact and in appearance.

Studies that tested auditor independence issues, such as those conducted by Gendron, Suddaby, & Lam (2006), Johari, Sanusi, Rahman, & Omar (2013), Chadegani, Mohamed & Jari (2011), Lindberg & Beck (2002), Palmrose (1997), and Abdulmalik & Ahmad (2016), indicated that auditor independence is maintained in line with the attitude of conservatism and the need to maintain credibility. Auditors also believe that non-audit services and other problems that threaten their independence has an adverse impact on the public's perception of the independence of auditors as well as the sustainability of public accounting firms where they work.

Previous studies on the independence of auditors were largely concentrated on the independent auditor valuation models or in situations where the independence of the auditor is violated. Research conducted by Schatzberg (1990) and Schatzberg and Sevcik (1994) attempted to study the concept of the independence of the audit process, but did not make observations on the subject directly, especially related to independence.

Matters relating to the suggestion that when external auditors perform an audit process for an independent assessment of the financial statements to be involved with ethical acti² is not a new concept or idea. Code of conduct such as that used by the American Institute of Certified Public Accountant (AICPA) and the Professional Standards Board Institute of Certified Public Accountants in Indonesia are typically designed to motivate members of professional organizations to operate in an ethical manner. Previous research suggests that behavioral problems that regulate the actions of the professional auditor is more complicated than the expectation that a professional auditor will comply with the code of conduct established by the organization (Lampe & Finn, 1992; Ponemon & Gabhart, 1993).

Ponemon & Gabhart (1993) stated that the level of morality of an auditor will explain the problems associated with the behavior and the independence of auditors. However, Cushing (1990) found that the research done by Ponemon & Gabhart (1993) possessed a weakness in terms of the audit scenario chosen. In an attempted to answer argument suggested by Cushing (1990) and Windsor & Ashkanasy (1995) proposed a case involving audit materiality dilemma related to errors in the accounting balance that will reported in the financial statements. Further, Windsor & Ashkanasy's (1995) research involves an analysis of the economic environment such as financial health of clients and the possibility of tendering in the selection of the external auditor.

Falk, Lynn, Mastelman, & Shehata (1999) in their research showed that the external review and potential fines (litigation costs, loss of reputation, or suspension of a license) can reduce violations of auditor independence and positive reinforcement to these attributes can be derived from the auditor's increased awareness on the ethical dimensions of their decisions. Results of this study validate research done by the Ponemon and Gabhart (1993) as well as Windsor and Ashkanasy (1995) related to the moral development of the independence of auditors.

Palmrose (1997) in his research discussed the status of the audit litigation. Litigation research suggests some pointers for future research from the perspective of the public against the policy debate on legal reform. One thing that is thorough in this debate is that the role of benefits in bringing and resolving lawsuits against the independent auditor. However, Palmrose (1997) did not address all types of research and research opportunities associated with litigation audit. Examples of other studies dealing with the issues of litigation audit are conducted by Matsumura, Yoo, & Tucker (2001), Dopuch & King (1991), Mironiuc, Chersan, & Robu (2013) and Schatzberg (1990). In conclusion, there are a number of issues worthy of study related to the avoidance and settlement of disputes, before getting to the litigation stage of the audit.

Auditor independence will help the stakeholders to ensure audit quality and contribute to the reliability of financial reporting process and improve the efficiency of capital markets. Lindberg and Beck (2002) in their research found that the perception of the Certified Public Accountant (CPA) on the relationship between non-audit services by the independent auditor is

negative after the events of Enron in 2001. The CPA holds a more conservative view on whether a transaction or event will materially and adversely affect the independence of auditors after Enron's bankruptcy, compared with before Enron declared bankruptcy. Furthermore, the findings suggested that the auditor believes non-audit services and other issues that threaten the auditor's independence has an adverse impact on the public's perception of the auditor's independence which is greater than the actual independence.

Hypothesis

This study aims to test the auditor's perception. The research utilized the quasi-experimental method in which each participant was given two main experiments materials with different pressure levels of audit litigation, and also was given a demographic data form and a manipulation check form procedure. Participant's perception indicates their level of independence in performing audit procedures.

Two settings were created through the procedure of quasi-experimental field (see Appendix, Section B: Experiment Instrument 1, and Section C: Experiment Instrument 2). In the first set, there are no penalties or fines caused by the auditor's independence (low pressure). Auditors will still get the client in any independence condition, without any threat of cessation of audit employment contract and threat of litigation related to the application of the law in Indonesia.

The second setting (high pressure level of auditor independence) indicates that there is a penalty or threat from the client, in the form of audit work cancellation if the auditor does not provide an audit opinion in accordance with the expectations and wishes of the client. In this setting audit clients could terminate contracts and auditor will also deal with threat of litigation.

In Setting 1 (Section B), the independent auditor will not lose their client even if they hold onto their own beliefs and they will not be punishable for the behaviors that are inconsistent. It is assumed that the independent auditors will issue an unqualified report when beliefs are consistent with the client while on the other hand it is assumed that the auditor will issue a qualified report if his beliefs are inconsistent with the client. Therefore, this hypothesis is as follows:

H1: When maintaining or violating auditor independence is of no cost, a professional auditor will keep their independence.

H2: In Setting 2 (Section C), the independent auditor may lose the clients if he publishes a qualified report. Also, the auditor will face pressure from the possibility of receiving threats of litigation for issuing unqualified report. In addition, it is possible if an auditor would be exposed to penalties if he violates the independence and open violations through peer review procedures. Therefore, this hypothesis is as follows:

H2: If the litigation costs and pressures that arise when an auditor issuing qualified report increase, the violation of the independence of auditors will increase.

With quasi-experiment method, there are two levels of pressure to measure the participant's perception about their level of independence in performing audit procedures and the relationship with moral and ethics. And the hypotheses tested using Chi-square and regression to analysis whether there is a change in the level of independence of auditors when they are exposed to some level of pressure of work related to morality and ethics, in two levels of work pressure (low and high pressure) and the threat of litigation.

Research Method

This research utilized the method of field quasi-experimental design with completely randomized samples. Quasi experiment is the development of a true experimental design. This design has a variable control but not fully used to control external variables that affect the execution of the experiment. In this experiment, quasi-experiment is shown through hypothetical material and cases have tiered levels of risk (low and high). It distinguishes with the survey research that generally the questions are relating to the variables, without involving the case level. Research with experimental method also allows the use of covariates, which in this study is period of work experiences (tenure). Experimental study also uses manipulation to check the procedure that serves as proof that any conditions had been created by researchers reached.

Two manipulated variables are the low and high levels of risk faced by auditors. Data was tested with Chi-square and regression analysis tools, which involved 47 professional auditors. Participants were asked to fill in the material involved in the experiments presented, which consists of four parts:

1. The first part of the form is related to the demographic data of participants (Appendix Section A).
2. The second part of the quasi experiment audit cases were configured in the form of the absence of penalties and any risk (low risk) that would occur if an auditor with a public accounting firm became a client of a company to give a qualified opinion (Appendix Section B).
3. The third section is configured in the form of audit cases with penalty in the form of termination by the client if an auditor with the public accounting firm gives a qualified opinion (high risk). As for the third part setting the form of the penalty in the form of termination by the client and also the pressure of facing the threat of litigation if an auditor with the public accounting firm to give a qualified opinion (Appendix Section C).
4. The last section is the part that the participants fill in the form to check manipulation procedures to determine whether the participant's answers and data are to be included in testing this hypothesis (Appendix Section D).

The experiment procedure asked participants to prepare for the provision of audit decisions and audit opinion, with several options of low and high risk. Participants were also asked to indicate the degree of confidence when preparing their audit decisions in the form of a percentage, which indicates whether they are very unsure (0%) up to very confident (100%). This study also uses one covariate. Covariate is the period of work experiences (tenure) of the participants as an auditor in months. Participants' experience are to control whether there are differences between participants who have long work experience and those with shorter work experience as auditors.

In this experimental study, there are several important concepts in terms of internal validity that need to be considered, as there are several threats to

be faced by participants as they follow this experiment (Putri, Baridwan, Supriyadi, & Nahartyo, 2013). The first is a matter of history, specific events experienced by subjects during the experiment. We did not plan or manipulated these events so as to affect the reaction of subjects. Simple experimental materials that are in accordance to the real condition faced by participants were used to minimize the threat of history. The second is maturity in the form of natural changes experienced by the subject as a result of the passage of time. This maturation problem can be solved by preparing short experimental material that is still able to answer the hypothesis. The next threat is internal validity testing, a disturbance in the experiments caused by changes in the ability or experience to understand the subjects in the experimental protocol. This disturbance can be overcome by arranging the experimental material that is easy to understand by the participants. Furthermore, another problem can arise from the instrumentation, which is caused by not using equivalent measurement instrument due to calibration changes. Instrumentation papers in this experiment are avoided by providing the same range of votes for each answer on a scenario experiment. And the last issue is mortality, that is, bias arising from the differences of level of maturation or autonomic changes. The threat of mortality is avoided by providing experimental material that can be completed in a short time (about 15 minutes) so it will prevent participants from boredom problems in the experiments.

Participants

Participants of this study were professional auditors who has the ability and capability to undertake audit procedures from beginning to compile reports on the audit opinion a public accounting firm, with minimal post of junior auditors. Auditors were chosen as participants because they are the ones who prepare the audit report and provide an audit opinion on the financial statements.

Auditors who become participants in this study are those who worked on the audit firms in the region of Central Java and Yogyakarta, Indonesia. Auditors are required to fill the experimental material, which is sent using postal services with postage reply that accompanied the sent experiment material.

This study also uses manipulation procedures check, which must be passed by the prospective participants after they followed the experiment. Participants in

this experiment are rewarded as compensation for the time they take to follow this experiment. The reward is in the form of souvenirs, and given at the end of the experimental procedure (after the experiment is finished). The purpose of giving a reward is that participants are motivated to complete all phases of the experiment so as to minimize the occurrence of mortality (participants are unable or unwilling to resolve all stages of the experiment).

Instruments and Experiment Procedures

The instrument used in this study consists of three major components.

1. General instructions.
2. Material experiments consisting of the general information and financial information of the hypothetical company in different risk levels (low and high), as well as questions regarding decisions related to audit opinions made by participants after they review general and financial information.
3. Charging part manipulations check, demographic data, as well as an explanation about the purpose which covers the implications of the implementation of this experiment.

Each participant in the same experimental instrument will receive three scenarios, in which first and second scenario respectively show the level or levels of risk to be borne by the auditors when they prepare a report on a particular audit opinion.

Participants were also asked to indicate the degree of confidence when preparing their audit decisions in the form of a percentage, which indicates whether they are very unsure (0%) up to very confident (100%). Selection is based on the level of risk information to improve participants' ability to perform analysis while conducting the audit. After randomization, participants were asked to do all the tasks assigned, and ending with charging manipulation check and charging demographic data. The overall time required to resolve cases individually in each application is approximately 15 minutes. The check provided about the manipulation procedure that must be answered by the participants. Problem manipulation check is used to control over the answers given by participants who showed how far participants' level of understanding of the case or treatment given.

Data Analysis

Hypothesis Testing

The hypotheses in this study were tested using the Chi-square test. Chi-square test was used to test the proportion or frequency. By using Chi-square test, it is possible to know whether the proportion or frequency in all cells tend to be similar or different. If the p-value obtained was significantly different between the three instruments on the test study, it shows the participants' experience difference in the presentation of information they received. Tests using Chi-square were done by comparing the participants' answers in the form of a decision for each instrument (risk level of low, medium, and high) in the study design. If the p-value obtained is less than 0.05 with a confidence level of 95% in testing the difference between the instruments then it means there is a difference in the decisions made as a result of a different problem.

The data from this experiment was also tested using regression analysis. The regression model is as follows:

$$\text{Independence} = a + \beta \text{Pressure} + \beta \text{Age} + \beta \text{WorkingTime} + \varepsilon$$

Independence at above regression model means the independence in appearance and independence in fact. This independence is measured through the answers of the participants. Participants' answers in giving the auditor's opinion in accordance with the level of

pressure that is received will show how independent they are in carrying out audit tasks. Meanwhile, the age and the working time measure were used as control variables to see the effect of those variables to the auditor independence in carrying out the audit tasks.

Results and Discussion

Participants in this study consist of 47 professional auditors from audit firms located in Central Java and Yogyakarta, Indonesia. Participants were asked to fill out a data sheet asking for demographics information such as age, years of service, as well as some other data. Furthermore, participants were asked to work on the experimental material in accordance with instructions given, and the experiment ended with the manipulation check procedure. In this experiment, all participants passed from manipulation procedures to check that the data in this study can be entirely processed to prove the hypotheses.

The participants were grouped into two categories wherein 44 were junior auditors and three were senior auditors. Of the participants, 37 have work experience as an auditor for up to three years, nine participants had a working period of 4 to 10 years, and only one has more than 10 years experience. Statistical test in this study uses work experiences as control variable.

Table 1. *Participants Demographic Data*

Professional Auditors	
Age:	
• 18 – 25 years old	5 participants
• 26 – 35 years old	32 participants
• 36 – 40 years old	9 participants
• More than 40 years old	1 participant
Working time (tenure):	
• 0 – 3 years	37 participants
• 4 – 10 years	9 participants
• More than 10 years	1 participant
Categories:	
• Junior Auditor	44 participants
• Senior Auditor	3 participants
• Manager	-
• Partner	-
Qualify from manipulation check procedures	47 participants

Hypothesis Testing Results

The hypotheses in this study were tested using the Chi-square test. Chi-square test is a test tool to determine whether the proportion or frequency in all cells in this experiment tend to be the same or different. The test results using the Chi-square test are shown in Table 2. The test result for the first hypothesis, which states that when maintaining or violating auditor independence of no cost, auditor will keep their independence, appears to have a significance of 0.047. This means that there are significant differences between the decisions made by the participants when they are faced with a situation where the pressure on employment is at a low level. This is shown with significance value lower than 0.05, which implies that participants' independence is not affected by the low-level work pressure in the preparation of audit reports, or in other words participants still try to maintain their independence as an auditor. This is supported by the provision of opinions in accordance with the conditions of a hypothetical company that is supposed to be, namely unqualified opinion with an explanatory language, amounting to 97.14%. The value proves that most of the participants chose to keep their independence for the provision of audit opinion in accordance with the actual audit results even though they have the opportunity to violate their independence. It also proves that the participant still holds auditing ethics to maintain their independence when performing their duties. It can be concluded that the first hypothesis in this study is **accepted**.

Statistical tests using Chi-square for the second hypothesis, which states that if there is an increase of litigation costs and pressure that arise when an auditor issue a qualified report, the violation of the independence of auditors will also increase, indicates a value of 0.047 for the category of non-professional participants and 0.039 for category of professional participants. This means that there are significant differences between the decisions made by the participants when they are faced with a situation where the pressure on employment is at a medium level. This however is shown with a significance value lower than 0.05. That is, participants' independence is not affected by the pressure of work preparation of audit reports, which are at high-pressure levels, implying that participants still try to maintain their independence as an auditor.

This is supported by the provision of opinions in accordance with the conditions of a hypothetical company that is supposed to be, namely unqualified opinion with an explanatory language, amounting to 95.74%. The value proves that most of the participants chose to keep their independence for the provision of audit opinion in accordance with the actual audit results even though they have the opportunity to violate their independence. It also proves that the participant still holds auditing ethics to maintain their independence when performing their duties. Thus, it can be concluded that the second hypothesis in this study is **rejected**.

Based on the results of statistical regression t-test in Table 3, it appears that the variable pressure, age, and working time showed no significant relationship

Table 2. Chi-square Test Results Statistics for Hypothesis 1 and 2

Treatment	The Answer by the Auditor as Participants			
	Unqualified Opinion	Unqualified Opinion with Explanatory Language	Qualified Opinion	Disclaimer
Panel A				
No risk	1 (2.13%)	46 (97.87%)	0 -	0 -
Chi-square statistical test 1:		4,54		
Chi-square and p-value H1		(0.047)		
Panel B				
The risk of relationship termination by the client and the threat of litigation	1 (2.13%)	45 (95.74%)	1 (2.13%)	0 -
Chi-square statistical test 2:		5,77		
Chi-square and p-value H2		(0.039)		

Table 3. *Statistical Regression*

Model	B Coefficients	t	Sig.
Constant	-.594	-.994	
Pressure	.007	.042	.343
Age	.005	.064	.571
Working time	.214	.129	.213

Dependent variable: independence

to the dependent variable (independence) at the 5% significance level. It can be seen from the significance probability value to pressure of 0.343, age by 0.571, and the working experience of 0.213 (sig.> 0.05).

Based on Table 3 shows the coefficients of the regression equation of this study, which can be arranged in mathematical terms as follows:

$$\text{Independence} = -0.594 + 0.007\text{Pressure} + 0.005\text{Age} + 0.214\text{WorkTime} + \varepsilon$$

Overall results of this study indicate that the pressure will not affect the auditor independence, either in the form of low-level stress or pressure that poses a threat of litigation. It shows by the significance point with value 0.343 (more than 5%). It means that despite the pressure, participants in this study indicate that the independence remains a priority in implementing the procedure in accordance with the profession as an auditor. The results are consistent with research done by Falk et al. (1999), Palmrose (1997), and Greenwood (2006). Thus, it can be concluded that the independence of auditors did not change significantly when associated with the job stress they experience.

Conclusion

Law of the Republic of Indonesia No. 5 Year 2011 that regulates Public Accountant requires a public accountant to maintain competence, integrity, and independence. This study sought to test whether an auditor who hypothetically experience different levels of pressure affects their independence. The study involved 47 professional auditors at auditing firms located in Central Java and Yogyakarta, Indonesia.

The results showed no significant difference related to the independence, morality, and ethics of auditors, caused by work pressure low and high levels of work pressure. Participants' independence was not affected even though they experienced different levels of work pressure. Participants also have the high confidence levels in their opinions and did not experience a significant change in perception due to the work pressure they faced. It shows that the professional auditors involved in this experiment have high degree of independence and are not affected by the pressure of work.

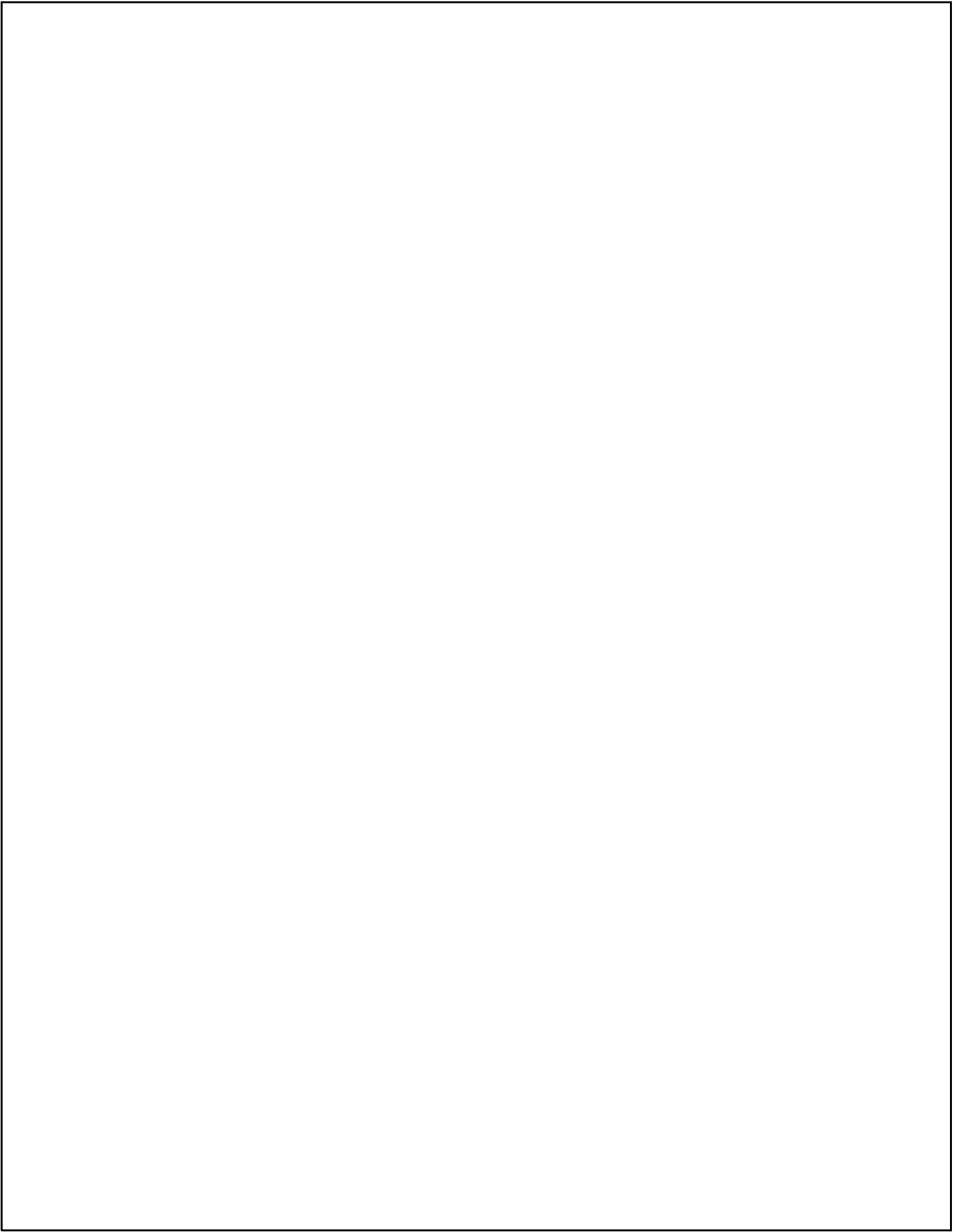
The implication of this research is that the auditor has to maintain his independence and constantly improve his competence to maintain his integrity as an independent auditor. Although the results of this study show that an independent auditor in Indonesia is able to maintain his independence and integrity, the government through the rules governing the profession of independent auditor must be constantly improved and continues to conduct regular supervision through authorized organizations on the performance assessment of professionalism of the independent auditors.

This study has limitations, mainly because the majority of the participants included are in the junior auditor category. For further research, it is necessary to engage participants that are considered to be in the category of senior auditors. Additionally, the data processing needs to be divided into two panel data, and expand the scope of research participants.

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