

# **CHAPTER I**

## **PRELIMINARY**

### **1.1 Background**

The rapid development of the business world today can lead to increased competition among business people. Various kinds of efforts to increase revenue and to stay afloat in the face of competition continue to be carried out by company managers. One of the policies often adopted by the company is to conduct an audit of the company's financial statements by a third party, namely a public accountant. Public Accounting Firm is an organization that is engaged in service, compliance audits and financial statement audit (Arens and Loebbecke, 2011).

In the case of auditing a financial report, it is necessary to have an auditor who has a great deal of responsibility and honesty in the auditing process, so that a financial report can be said to be fair. Companies that are growing rapidly, whether engaged in services, trade or manufacturing, will certainly always be dealing with small and large problems such as problems in the product or management of their company and the financial section of the company. With the problem, the company needs efforts that can maintain and develop good efforts in terms of productivity, efficiency, effectiveness, and professionalism of an audit in auditing the company's financial statements, so that the company's goals can be realized. Therefore, companies also need auditors or public accounting services to audit financial statements properly and correctly.

An audit who is honest in carrying out his duties and works without coercion or pressure from certain parties for his interests will still be able to maintain integrity. The breadth of the need for professional services for public accountants as a party that is considered independent forces the public accounting profession to improve its performance to produce audit products that can be relied on by those in need. To be able to further improve the performance of professionalism in conducting audits of financial statements, public accountants should have extensive knowledge of auditing and be accompanied by an understanding of the professional code of ethics (Herawaty and Susanto, 2009).

A public accountant in carrying out and carrying out audits of financial statements does not work only for the benefit of his clients, but also other interested parties regarding audited financial statements, such as companies. To gain the trust of clients and other users of financial statements, accountants must be able to maintain the trust of their clients through their independence.

The more a company develops, the more complex and unreasonable the activities and problems a company faces, so it will be difficult to control in terms of monitoring all activities and operations of the company, where there is a high likelihood of irregularities, waste, corruption, and fraud. the workers in a company. One of the problems that often occur in companies is internal problems that arise in an organization which can indicate that the functions within the organization are not carried out consistently, resulting in the unhealthy implementation of corporate governance.

One of the phenomena in the business world is the Enron Corporation case. Where previously Enron's financial statements were declared fair without exception by the accounting firm Arthur Anderson, one of the public accounting firms in the Big four ranks, but on December 2, 2001, it was declared bankrupt. Bankruptcy was caused because Arthur Anderson provided two services at once, namely as an auditor and a business consultant.

In addition, there is a phenomenon that occurs in one of the public accounting firms in Khairul (2012) in Pekanbaru. Namely cases of fraud or falsification of auditing financial statements using the accountant's name, stamp, and letterhead that were falsified. Even though it is known that the accountant did not do or make the financial statements. Based on the above case, public accounting services are the most responsible profession, this is due to their important role in the business community (Sri Nayuni, 2017).

One of the things to overcome this risk, a company must carry out a supervisory function to be able to carry out controls in terms of managing risk control, system control, and management arrangements that are fair, honest and have full responsibility in managing a company, and an auditor must have independent nature and professional ethics in auditing a financial report in a company. When the audit process is carried out, the audit report will be of use to the interests of the company as well as the interests of parties from outside the company, such as potential investors. Good and correct auditing will gain the trust of potential investors for a company.

The purpose of an audit is to increase the confidence of the intended users of the financial statements. This is achieved by expressing an opinion by

the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. In the case of most general purpose frameworks, the opinion is about whether the financial statements are presented fairly in accordance with the framework. An audit conducted in accordance with audit standards and relevant ethical requirements enables the auditor to form an opinion (SPAP SA 200).

The process of examining the company's financial statements is then given an opinion which is commonly referred to as an audit opinion. The definition of an audit opinion is that the report provided by a registered auditor states that the results of the assessment and examination of financial statements are of a fair value, which is said to be fair when a financial report conforms to the accounting rules or norms applicable in auditing by financial parties in the company.

The parties who are responsible for auditing a financial report must have the trust of the wider community. Therefore, a public accountant must pay attention to the quality of an auditor's work. To maintain the trust of the public, public and auditing accountant must also pay attention to politics, including in terms of political relations with a company.

A company with a political connection is a company with a certain political connection or that is involved in doing business the existence of closeness to politicians or the government. Political connections are believed to be an invaluable resource for many companies (Leuz and Gee 2006).

Political connections occur because the characteristics of countries in Asia are a country with a concentrated ownership structure, low law

enforcement and public oversight, low protection of minority shareholders which causes political connections to become a consideration for companies so that business can run smoothly (Claessens, 2002; Hwang, & Wu, 2004; Klapper & Love, 2004).

The existence of political connections in companies emphasizes that there are parties within the company who can influence financial reporting by exploiting company resources and ignoring investors. Or it can be said that the existence of political connections within the company can manipulate financial statements with the aim of hiding information on economic performance to ensure that distraction from political cronies and corruption is not revealed (Guedhami, Pittman, & Saffar, 2014). This will affect the quality of earnings generated by companies with political connections.

Companies with political connections can choose qualified auditors because the company sends a signal to the outside world that the company is transparent. On the other hand, companies that have political connections can also choose auditors with lower quality to cover up fraud committed by the company because auditors often lack supervision.

One of the phenomena that causes the increase in firm value is the existence of political relations between the government and companies, which shows that companies in developing countries have a strong incentive to use political connections to benefit from government thereby increasing the value of the company. The intervention of the government as the main shareholder shows the government's confidence in a company. In addition, the government also acts as guarantor of the business so that it can increase stock trading

activity. This shows that high company value as a result of political connections can increase stock trading activity in the market capital (Yusuf Akhamadi;2020).

This is because politics has its impact on the disclosure of financial information and there is often a relationship between political connections within the company, both during accrual and real activities. An example of the phenomenon of Indonesian political relations has previously occurred, namely during the presidency of President Suharto, namely the provision of free import licenses to companies that have political relations with the Soeharto government (Mobarak and Purbasari 2006 in Nurhayati 2012). According to the Indonesian Corruption Watch, 48 elected legislative members were affected by corruption cases.

Therefore, companies that have political relations will get very tight supervision by the public or the public, so there is a high risk of detection, so the company will choose real management so that it is not easily detected. The use of real management in a company is to base political relations and the existence of auditors who have existed in the company since previous periods (Chi et al. 2010).

Auditors have an effective role in limiting aggressive reporting carried out by company management. The ability of an auditor can be seen from the size of the public accounting firm used by the company through the length of the auditor's tenure in a company. An auditor must have an independent attitude, an independent attitude means that it is an impartial attitude. Auditors have an obligation, to be honest not only with management and leaders in

agencies but to the public or society and other parties who place their trust in auditors in a company. In carrying out their duties, KAP members must always maintain an independent mental attitude in providing professional services as regulated in the Public Accountant Professional Standards set by IAI.

Arens and Loebbecke (2003) define independence in auditing as holding a fair or impartial view of the implementation of audit tests, evaluating test results, and preparing audit reports. Justice can be formed in two perspectives, as follows :

1. Independence, in fact, means that accountants can maintain a fair attitude in carrying out audits.
2. Independent in appearance (Independence in Appearance), which means that accountants act fairly according to the perceptions of users of financial statements.

From the explanation above, independence is an important thing that must be owned by auditors. An independent auditor will provide a fairer and more precise assessment of the information and evidence they obtain. Without taking sides and taking sides, the auditor's assessment will reflect the actual conditions of the client. Thus, the reliability and quality of the reports provided by the auditors can be trusted by all stakeholders.

Apart from independence, an auditor must have professional auditing ethics. Boynton et al (2001) stated that "Ethics (ethic) comes from Greek ethics, which means character. Another word for ethics is morals (morality),

which comes from the Latin mores, which means habit. Therefore ethics is concerned with the question of how people will behave towards others."

An audit who is honest in carrying out his duties and working. A public accountant in carrying out his profession is regulated by a professional code of ethics, known as the Indonesian accountant code of ethics article 1 paragraph 2 which states that each member must maintain integrity, objectivity and independence in carrying out their duties.

In Indonesia, the issue of accountant ethics develops along with the occurrence of several ethical violations, whether committed by the public, internal, or government accountants. Ethical violations by public accountants are giving an unqualified opinion for financial statements that do not meet certain qualifications according to the accountant's audit norms or SPAP. The public accounting professional standard is a document that contains a framework and guidelines, which have been agreed upon and approved by the competent authorities, for public accountants in providing their service delivery practices (IAI, 2001; Arens, Beasley, & Elder, 2003), namely standard generally accepted auditing, accounting and review service standards, attestation standards, and quality control standards.

According to the Professional Standards for Public Accountants (SPAP) SA 200 The Purpose of Independent Auditors and Conducting Audits Based on Auditing Standards states that the applicable financial reporting framework often includes financial reporting standards set by a standard-setting organization that is authorized or recognized by the regulator or according to regulatory requirements. In some cases, the financial reporting

framework may include financial reporting standards determined by a standards-setting organization authorized in legislation. In some cases, the applicable financial reporting framework may include other sources, namely :

- The legal and ethical environment, including statutes, regulations, judicial decisions, and professional ethical obligations about accounting matters,
- Accounting interpretations with multiple powers published by standards-setting organizations, professional organizations or regulators,
- Views on current accounting issues with multiple powers published by standards-setting organizations, professional organizations or regulators,
- Widely recognized and prevalent general practice and industry,
- Accounting literature.

If there is a conflict between the financial reporting framework and other sources that provide direction in the application of the financial reporting framework, or if there are conflicts between various sources covering the financial reporting framework, the source with the highest authority is the source that must be used.

Professional ethics in accounting, an accountant must pay attention to things that are not desirable to happen in a financial report. To avoid these undesirable things, an accountant must fulfill his duties and responsibilities as a professional accountant by understanding good professional ethics so that he can work optimally, including by making detailed financial reports. One of the

criteria for professionalism is the timeliness of submitting audit reports in publishing financial reports to the general public and the financial services authority (OJK). The different between the financial statement date and the date of the audit opinion on the financial statements inform the length of time that the audit work has been completed. Professional ethics must be owned and obeyed by every profession that provides services to citizens and can serve as a sense of religion for the wider community. It can be said that every professional must always adhere to professional ethics related to using services that concern the wider community's interests. The Public Accountant Professional Standards (SPAP) are an excellent reference for the quality of an audit. The ethical principles formulated in the IAPI (Indonesian Public Accountants Association) and as a guide to the behavior of Indonesian accountants are :

1. Responsibility,
2. Community interests,
3. Integrity,
4. Objectivity and independence,
5. Competence and professional requirements,
6. Confidentiality and
7. Professional Conduct.

An auditor in a company must have the main task of carrying out auditing, providing audit opinions on company financial reports based on regulations based on experience, professionalism, competence, objective, and not taking sides with anyone.

In planning the audit, the public accountant is obliged to consider the case for determining the level of planned control risk and the initial consideration of the level of materiality to achieve the audit objectives. To be able to consider and choose bets, a public accountant must know how to detect errors. Where this activity is very influential on the final audit report on the opinion given.

Giving an audit opinion that is synchronous and following the criteria set out in the Professional Standards for Public Accountants (SPAP, 2011) is very important so that the audit output does not make a mistake with interested users (company leaders, shareholders, government, creditors, and employees) in making decisions. Therefore, the audit must be carried out using the best possible. After the opinion given by the auditor is very important for a company, the auditor is required to have good independence to be able to collect and analyze audit evidence as a result of being able to put an opinion correctly. Lack of auditor independence and rampant manipulation of corporate financial statements have lowered users' trust in audited financial statements. Users of financial reports, such as investors and creditors, question the existence of public accountants to become independent parties.

At this time, Indonesia is experiencing a difficult time caused by a dangerous virus called covid-19 where people experience massive unemployment and an economic crisis caused by the entry of a virus called covid-19 into Indonesia since early March 2020 until now, the virus it is not muted either. The existence of the virus-19 has a special impact on the economy in Indonesia starting from the industrial sector including tourism,

retail, and manufacturing as well as in companies that have an impact on the implementation of layoffs, reduced recruitment, preferred outsourcing, priority multitasking workers, many companies permanently closed, only technology companies are developing, and the running of companies and organizations within the company becomes disrupted.

The impact of the Covid 19 pandemic can also affect the results of obtaining audit opinion evidence, for example, the implementation of PSBB (large-scale social restrictions) will inevitably impact access and travel restrictions as well as the availability of personnel from auditors and auditees, auditors need to make relevant changes in this case exploring alternative audit procedures. Auditors need to observe how ISA 330 (Auditor response to assessed risks) guides in identifying changes relevant to the auditor's ability to obtain sufficient appropriate audit evidence during this time of the pandemic. Therefore, the auditor must maintain audit quality and be able to obtain sufficient appropriate audit evidence to support the audit opinion.

The required auditor response is to modify the audit evidence-gathering mechanism, revise the process of identifying and assessing the risk of material evaluation error, update the planned audit mechanism, or implement other means or follow-up as appropriate.

Several things are significant to support the performance and quality of audit opinion during the Covid-19 pandemic, for example, obtaining relatively and perfect audit evidence, which emphasizes that it is the auditor's responsibility to obtain relative and perfect audit evidence before issuing an audit report. It is recognized that restrictions on access and travel and limited

availability of personnel resulting in health considerations may impair the auditor's ability to obtain relative and complete audit evidence. Completion of high-quality audits on current requirements requires additional timing, which could affect reporting deadlines.

As a result, the auditor needs to postpone the issuance of the audit report. When this cannot resolve the case, the auditor needs to update the audit report to reflect that the auditor has not obtained the necessary audit evidence.

Auditors need to communicate carefully with management and those charged with governance in determining this so that the auditing process of a financial report in the company produces an independent, ethical audit opinion following the rules for auditing a financial report. (auditor response to the covid-19 pandemic - IAPI)

Based on the background of the above problems, this study intends to review the factors that affect auditor performance. Previous research conducted by Dian Mayasari in 2011 with the title Influence of Professionalism, Independence, Competence, Professional Ethics, and Auditor Knowledge in Detecting Errors on the Accuracy of Providing Audit Opinions by Auditors (Empirical Study at Public Accounting Firms in Jakarta) which obtained the results of the research, namely It was found that professionalism, independence, competence, and knowledge of the auditor in detecting errors had a significant positive effect on the accuracy of the auditor's giving of the audit opinion. Meanwhile, professional ethics has a significant negative effect on the accuracy of giving audit opinion by auditors. Competence is the most dominant independent variable on the accuracy of giving audit opinion by the

auditor. Based on the previous research, there are differences that underlie further research in this study regarding the influence of independence, political relations, professional ethics on the accuracy of giving audit opinions by auditors at Public Accounting Firm At Medan. The existence of research variables that are different from previous studies can provide broad knowledge about the matters that affect the accuracy of auditors in providing audit opinions. Therefore, as a writer, I took the initiative to raise the title of the research **"THE INFLUENCE OF INDEPENDENCE, POLITICAL RELATIONS, AND PROFESSIONAL ETHICS ON THE ACCURACY OF GIVING AUDIT OPINION BY AUDITOR (Empirical Study In Public Accountant Firm At Medan). "**

## **1.2 Problem Identification**

Based on the background description of the problem above, it can be concluded that the problem identification is :

1. Whether the auditing process for financial statements In Public Accountant Firm At Medan, in providing audit opinion is correct or not.
2. With the accuracy of the audit opinion, the auditor will be more precise when providing audit opinion without manipulating that opinion.
3. The existence of political relations makes the auditors and their opinions tighter their supervisory system and increases their relationship with one another.

4. Independence, political relations and professional ethics will affect the appropriateness of giving the audit opinion by the auditor

### **1.3 Problem Limitation**

For the problems in this study to be clearer and directed at one point of focus and clear, it is necessary to have a problem limitation to achieve the desired objectives in this study. Therefore, researchers limit only the influence of independence, political relations, professional ethics on the accuracy of giving an audit opinion by an auditor In Public Accountant Firm At Medan.

### **1.4 Problem Formulation**

There is a problem formulation in the background that has been described above, namely :

1. Is There any influence independence on the accuracy of giving audit opinion In Public Accountant Firm At Medan?
2. Is there any influence political relationship on the accuracy of giving an audit opinion to Public Accountant Firm At Medan?
3. Is There any influence of professional ethics on the accuracy of giving an audit opinion In Public Accountant Firm At Medan?

### **1.5 Research Objectives**

Based on the formulation of the problems described above, the research aims to :

1. To Determine the effect of independence on the accuracy of giving audit opinion by the auditor in Public Accountant Firm At Medan.
2. To Determine the effect of political relations on the accuracy of giving an audit opinion by the auditor In Public Accountant Firm At Medan.

3. To Determine the effect of professional ethics on the accuracy of giving an audit opinion by the auditor In Public Accountant Firm At Medan.

### **1.6 Research Benefits**

Every research that is done, must have its benefits. The benefits of this research are :

1. For researchers

Through a series of processes undertaken in this research, it can help the author by deepening knowledge about the influence of independence, politics, and professional ethics on the accuracy of giving audit opinions and being able to know the audit rules in the professional standards of public accountants in auditing financial statements. Also, providing experience in observing companies so that it can be the first step in knowing how the process works properly and correctly according to the rules in the company.

2. For Users Of Accounting Services

Can be used as material to improve the quality and quality of an auditor in the company. So that the company's goals can run according to a predetermined plan.

3. For the public, readers, or other parties

This research can be used as reference material for conducting future research as well as providing broad insights about auditors who are independent, ethical according to professional standards of public accountants, and know how to provide audit opinions appropriately.