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AUDIT FIRM PERFORMANCE MANAGEMENT CONTRIBUTION TO AUDITOR'S ETHICAL DECISION MAKING IN DEALING WITH DYSFUNCTIONAL CLIENT

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ABSTRACT

The work environment of the auditors has a significant influence on the ethical decisions made. the reflection of the auditors' performance is directly proportional to the environment that forms their skepticism as well as the leader who leads them. The author wants to reveal how performance management in an audit firm contribute to auditor's ethical decision making. Furthermore, the author uses the literature review from reliable journals as evidence of the statement to describe the ideas and issues in this study.

The findings in this thesis contribute to providing suggestions for audit team leaders in improving firm's performance management in contributing to auditors' ethical decision-making.

Keywords: *Auditor, external auditor, auditor ethical decision-making, ethical decision-making process, ethical behavior, performance management, auditor independence, leadership*

INTRODUCTION

Audit has become an annual activity that is required of every company. Auditors must be independent so that audit quality is maintained and stakeholders as well as shareholders can rely on the opinions given to the company. Audit quality is the process of systematic examination of a quality system carried out by an internal or external quality auditor or an audit team. The purpose of maintaining audit quality is to provide confidence in the quality of financial reports. Auditors need to improve audit quality and the consistency of audit execution is essential to maintaining confidence in the independent assurance they provide.

The accounting and auditing professions must rely on the accounting profession code of ethics which regulates the rules and norms in the professional sphere. Although accountants and auditors adhere to the guidelines they have, challenges are sure to follow them. An example of this problem in auditing context arises when the client is less alert in providing the data requested by the auditors. This results in the audit taking too long of the required duration. Being labor intensive, controlling cost on an audit involves controlling the time input, and research indicates that audit teams experience extremely high time pressure on audits (Sweney & Pierce, 2004). Audit quality is difficult to measure (Power, 2003). Often, efforts to increase the quality of an audit involve investing more time in the audit, which leads to further cost (Sweeney, Arnold Sr, & Pierce, 2010). This is where the role of performance management in auditing firms contributes to ethical decision making to decide what to do by auditors if they

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face similar challenges. As Hamel (2009) did in describing performance management by led a group of experts and CEOs and proposed a road map for reinventing management, identifying 25 management's grand challenges. According to their view, managers need ability to build a culture of mutual respect and collaboration in order to engage everyone in the idea generation and strategic thinking process (Bititcia, Cocca, & Ates, 2016). They suggest that organizations must create a 'democracy of information' where employees at all levels of the organization are internally and externally informed and empowered so they can feel engaged and act intelligently in the interest of the entire enterprise (Bititcia, Cocca, & Ates, 2016). Auditors are obliged to strictly adhere to high behavior standard during their work but also in all communications with staff of audited organization (Jelic, 2012). A considerable amount of the research on ethics in the auditing profession uses the Rest's 'ethical reasoning process' model and most of that research focuses on two of the four elements, these being individuals' moral reasoning and ethical intensity. However, there has been limited testing of the impact of these contextual variables on the Rest model and not many studies have tested this model in small audit firms.

This study was conducted in Indonesia, which is the most populous country in Southeast Asia, with the largest economy. The aim of this study is to examine how management performance in one of a small audit firm which located in Capital of Indonesia; Jakarta, contributes to ethical decision-making using Rest's model in the context of a time-pressure associated with dysfunctional client behavior. Data were collected using interview method from auditors working in audit firm "Sigit Sunarno".

THEORITICAL FRAMEWORK

In this research, there are three theories used which are expectancy theory, decision-making theory and goal-setting theory. Vroom's Expectancy Theory of Motivation posits that the individual evaluates choices and makes decision based on the choice that is believed will lead to the most desirable personal outcome to optimize pleasure and minimize pain (Vroom, 1964). According to Purvis, Zagenczyk, & McCray (2015), expectancy theory explains motivation on the degree to which an effort is perceived to lead to performance, performance leads to reward, and the rewards offered are desirable. This theory underlines the concept of performance management as it is believed that performance is influenced by the expectations concerning future events (Salaman, Storey, & Billsberry, 2005). One area in which expectancy theory differs is in its inclusion of the instrumentality factor that takes motivation a step further, that is the belief that performance will lead to the desired outcome (Zboja, Jackson, & M., 2020). Hence, it is important for audit firms to keep their auditors motivated in carrying out the audit task of audit partners with motivational support from their own firms.

Decision-making is a fundamental process because in order to make the right decision, one is faced with several alternative choices that have concequences (Duffy & Atwater, 2002). Duffy and Atwater (2002) define decision-making as a process of integrating information about relevant alternatives and making the right choices. De Janasz, Dowd, & Schneider (2002) define decision-making as a process to make an appropiate decision. Decision-making must be carried out quickly and precisely, so that it suggest someone must have ability to eliminate unnecessary steps, intergrate knowledge, and simplify the decision-making process. Moreover, because auditor ethical decision making is closely related with financial information from the audit partner, there are several things that influence it such as moral intensity, ethical ideology, ethical climate, professional ethics, and commitment to serve the profession.

Another theory that supports performance management is goal-setting theory. Goal-setting theory focuses on the core of properties of effective goals, with a primary interest in predicting, explaining, and influencing performance (Locke & Latham, 2002). Locke &

Latham (2002) argued that the higher the goal, the better the performance and that performance will level off or decrease only when the limits of one's ability are reached or when commitment lapses. Goal-setting theory has a central focus on the nature and process of setting goals (Swann, et al., 2020). In accordance with that statement, Latham et al. (2007) stated that goal-setting theory of motivation satisfies three criteria. They are causal relationships must be specified, mediators that explain the causal relationships must be identified, and the boundary conditions within which the theory is applicable must be known (Latham, 2016). This theory also provides a comprehensive understanding to linkage and to hypothesize about the impact of performance management contribution within an audit firm to auditors' ethical decision making.

The Risk of Material Misstatement Faced by Auditor

One of the key assessments that auditors make during the planning process is the assessment of fraud risk (Popova, 2018). According to Mohd-Sanusi *et al.* (2015), auditors are required to have a good understanding of these fraud risk (fraud reasoning motives) when conducting their audit task.

Auditors have to assess risks of material misstatement before giving a reasonable assurance that the audited financial statements are free from material misstatements (Hussin, Iskandar, Saleh, & Jafar, 2017). Risk assessment and planning considerations are two important aspects of the auditor's ability to deal with the risks addressed by audit partner. During the planning phase of an audit, risk of material misstatement (RMM) is traditionally assessed by considering potential sources of misstatement (i.e., inherent risks (IR) and control risks (CR)) (Popova, 2018). Empirical studies show that control risk factors appear to be related to the incidence of misstatement (Wright & Wright, 1996; Wallace & Kreutzfeldt, 1995; Eilifsen & Messier, 2000; Ruhnke & Schmidt, 2014), whereas control risk appear to be related to audit procedures (applied by auditors) and to the detection of adjustments (Wright & Ashton, 1989; Ruhnke & Schmidt, 2014).

General Perspective of Performance Management

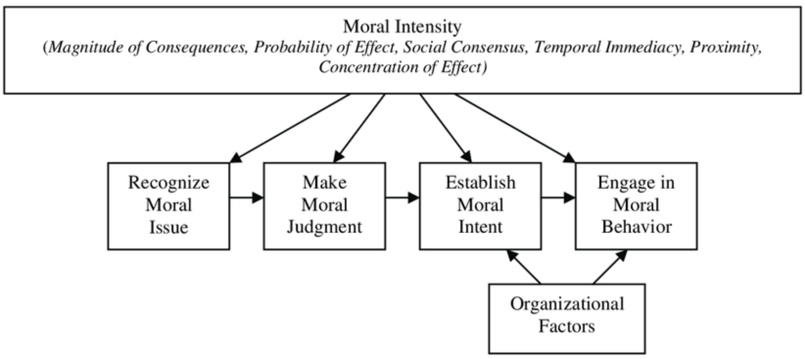
According to Minculete & Olar (2015), the term performance is used at all levels of public organizations in order to express the remarkable results obtained at the level of the individual, team or group, compartment (office, service, unit, subunit, etc.) in the structure of the entity. The performance concept through the connection of the three mentioned concepts with the logic of three distinct categories: a logic of effectiveness, efficiency and budgeting (Bartoli, 1997; Minculete & Olar, 2015). Some of the roles of a system of measurement of performance in a public organization mainly envisage: checking the organizational progress for attaining the set objectives; making individuals (employed in a public organization) aware with regard to aspects of special importance for organizational success, but also on the problems in the domains identified at least competitive (or even uncompetitive); the designing at organizational level of adequate objectives and efficient and effective functioning-development strategies, regardless of the level of results obtained at a certain moment (Minculete & Olar, 2015).

To be ethically commendable, the quality team leader should serve as a supervisor and remain willing to recognize good work and offer constructive criticism for involvement in performance (Jelic, 2012). In today's competitive marketplace, leaders in organizations from around the world are searching for ways to produce high-quality, highly profitable, customer-satisfying products and services (Goffnett, 2020). Many business leaders have pursued the goal of implementing an ISO 9001 certified quality management system (QMS) in effort to achieve competitive advantage (Naveh & Marcus, 2005). Leaders pursue certification because of internal and external motives (Boiral, 2003), such as to achieve competitive advantage or to enhance corporate image (Briscoe, Fawcett, & Todd, 2005). At the end, the team leader must assure that he and the rest of team members maintain their integrity (Jelic, 2012).

Ethical Model of Auditor Decision Making

Attention to ethics of auditing engages the professional firms only with respect to risk minimization in relation to the serious illegal activities of the occasional 'bad apple' and the likelihood of legal liabilities and a general concern for their reputation (Jelic, 2012). To support the ethical performance of auditors, a supportive ethical climate is needed. According to Jelic (2012), ethical climate is "the shared perception of what behavior is right" and is "based on members' perceptions of typical organizational practices and procedures involving ethics".

Auditors in their daily life encounter situations with different levels of moral intensity and the literature shows a significant positive effect of the characteristics of a situation on auditor's ethical decision making when facing ethical dilemmas (Lehnert, Park, & Singh, 2015). On top of that, Jones (1991) further strengthened the scope of ethical decision-making models by further taking into account the characteristics of ethical issues and proposed that ethical decision making is also contingent on moral intensity of the ethical situation. In line with that statement, Rest (1986) describes ethical decision-making as four steps represented in the Figure 1. First step is recognition of a moral issue (moral awareness); the individual must be able to identify situations that involves ethical problem. Second step is evaluation of the information received and available options (moral judgment); the individual can make judgment about the action should be taken by indicating the attitude that person should behave in response to moral issues. Then, intention to make decision (moral intention); the individual must have intention to act ethically. Finally, subsequent behavior or mere decision (moral action); the individual must act on the ethical problem in order to solve it.



RESEARCH METHODOLOGY & ANALYSIS

The investigation has shown that ethical decision making has become an important concern in maintaining auditors integrity. Ethical decision making can be understood as deciding or judging whether the action or decision is ethical (Lehnert, Park, & Singh, 2015). Given that the internal control system is designed to minimize risks such as financial fraud, it will rely heavily on moral reasoning which is conducted by auditors (Latan, Chiappetta Jabbour, & Lopes de Sousa Jabbour, 2017). However, auditors are often faced with ethical issues that conflict between professional ethical codes and ethical decisions.

The financial frauds together with audit failures have been progressively a hot issue (Mohd-Sanusi, Khalid, & Mahir, 2015). Moreover, failures to assess potential fraud risk will expose an organization to serious consequences. Auditors must be able to detect fraud risk such as material misstatement in order to facilitate the audit process. The audit firm "Sigit

Sunarno" minimizes the presence of audit risk by selecting prospective clients at the acceptance phase with analyzing financial reports and potential clients' intentions in auditing their company before deciding to reject or accept them as a client. If misstatements were discovered during the audit process, it will take longer time than usual. Most client business risks eventually have consequences to the financial statements, and authoritative guidance specifically states that the auditor should consider that the effect of client business risk in planning the audit (AICPA, 2006a; IAASB, 2004b). Thus the association between client business risk and evidental planning is important to both standard setters and practitioners (Blay, Sneathen, & Kizirian, 2007).
The auditor should plan and perform an audit within an attitude of professional skepticism recognizing that circumstances such as fraud risk may exist that cause the financial statements to be materially misstated (Glover & Prawitt, 2014). A lack of an exercise of the skepticism attitude among auditors may have serious implications with fraud-related cases (Hussin, Iskandar, Saleh, & Jafar, 2017). Therefore, maintaining an attitude of professional skepticism requires auditors to have an ongoing sense of questioning of whether the information and audit evidence obtained suggests that a material misstatement due to fraud may exist. According to Nelson (2009), skepticism practices improve the assessment of audit risk to the information that can affect judgment and results of the audit. As time goes by, skepticism will emerge from auditors experiences which aligned with the length of work duration as an auditor. It is important to note that, regular dicussion or brain-storming with the audit team will sharpen the ability of auditor skepticism.

As explained before, good leadership acts a very vital part and leading towards better performance and accomplishment of organizational goals (Shah, Hamid, Shaikh, Qureshi, & Pahi, 2016). The job performance is considered as one of the key indicator to measure the performance of organization as seen in many studies (Wall, et al., 2004). Johari & Yahya (2009) argued that, in order to improve employee job performance there is a need to identify whether current organizational structure is supportive or not and also refine job characteristics so that the employees can be encouraged to perform at their highest possible outcome. Small audit firm leader tend to motivate their auditors in the form of encouraging words so auditors do not see their duties as a burden when dealing with dysfunctional clients.

Since every organization have its own vision, and strives to maximize performance to achieve its goals, leaders have an important role to play and to ensure the company they lead is running on the right track. Communication is an important aspect to improve individual performance in the workplace. The audit firm continues to provide updates to its auditors with routine audit training in order to expand the capacity of the firm's clients and also the leader divides tasks among all employees equally so that employees feel that they are contributing to achieving the firm's goals. The employees who are highly engaged with high energy, high level of enthusiastic in work and found engrossed fully towards the job and feel the time is flying all the way (Macey & Schneider, 2008; May, Gilson, & Harter, 2004). In addition, audit firm leader also contributing to overcoming material misstatement by becoming a mediator. The fim leader is a person who communicates the form of the problem found to the leader of the client company in a language that is easily accepted based on the background of client’s company leader.

The consequences of dysfunctional behavior either to an accounting or audit firm can be costly both for the individual and the firm (Beekes, Otley, & Ururuka, 2014). Sweney & Pierce (2004) argued that dysfunctional behavior could lead to termination of employment for the individual, and damage to reputation and increased potential for litigation for the firm. If auditors work on disfunctional client unintentionally, the firm tend to discuss issues occur with the team and always came out with alternative procedures. To anticipate any issues, the audit team decidedly has alternative procedures as a back up plan for clients being audited before audit procedures conducted.

Indeed, performance management is a key factor behind company's accomplishment. The performance of the organization is based on absolute or relative judgment, which is considered as the true reflector of overall performance (Gomez-Mejia, Balkin, & Cardy, 2007; Wall, et al., 2004; Shah, Hamid, Shaikh, Qureshi, & Pahi, 2016). The way audit firm contribute to make an ethical decision making is by providing assessment form for auditors. The assessment form is a form contains the details of areas needed to be evaluate, measure or identify. Internal Control Assessment Form for instance, accommodate points such as participation by those charged with governance, management's philosophy and operating style, communication and enforcement of integrity and ethical values, assignment of authority and responsibility, human resources policies and practices & commitment to competence and so on. Assuming that the client is cooperative, transparent, and has good internal control then auditors will give good assessment on client indubitably. In addition, a set of results of the assessment will lead to final opinion given by auditors in the end of audit process.

Under decree of the Minister of Finance of the Republic of Indonesia number 423 / KMK.06 / 2002 Article 6, the provision of general audit services on the financial statements of an entity can be carried ot by public accounting firms for a maximum of five consecutive financial years. Although limited to only five years, this time limit may give rise to certain threats due to intense feeling between clients and auditors (familiarity or family threats). The auditors are required to have skepticism so as not to immediately believe what the client said to minimize collusion and the threat of familiarity that occurs between the client and the auditor.

The existence of last-minute evidence from clients is another possible pressure for the auditor. However, the auditor's opinion will not be easily changed due to the last-minute evidence given. The auditor then will review the documents provided and identify whether the evidence provided is relevant or not and has an impact on the current year's audit work or not. If the final data from document given has significant impact, then it will have an impact on the auditor's final opinion. To ensure that the opinion is independent, audit firm consistently obligate auditors to fill out an Independence Form which states that the auditor in charge has no interest in the client. With this form, the audit firm can guarantee the independence of the opinions of the auditors within the firm.

At last, the way audit firms form and cultivate the mindset of auditors is by requiring training such as annual training for Generally Auditing Accepted Standard or internal discussion to shape auditor skepticism. Auditors also required to maintain communication with the entire team in order to diminish differences in opinion between auditors.

CONCLUSIONS

The research reported in this paper was conducted to determine the way audit firm use performance criteria to improve auditor ethical decision making. This chapter will deliver the conclusion of literature review of each sub-question based on interview conducted and will lead into the main question, which approaches taken by an audit firm to contribute to auditors' ethical decision making through performance management. It should be noted that the public attention towards the accounting profession is very large due to the discovery of corporate financial scandals involving accountants (Budisusetyo, Subroto, & Solimun, 2018). This shows the empirical fact that independence and ethics in the accounting profession are an important concern (Budisusetyo, Subroto, & Solimun, 2018). Auditors are often faced with a dilemma that they cannot be independent in their work (Finn, Chonko, & Hunt, 1988; Bazerman, Morgan, & Loewenstein, 1997; Kaplan, 2004). Auditors are in a situation that requires them to decide between choises and ethical implication for various parties, that is the main reason why the dilemma situations often arise. Clement, Neill, & Stovall (2012) state that, an auditor inherently has a conflict of interest when interacting with clients. Thus, the relationship between the auditor and the clients sometimes leads to a dilemma situation. Kaplan (2004) refers to the relationship between the auditor and the client as the main causes of conflicts of interest in the accounting profession. Therefore, the dilemma has the potential to become an obstacle for auditors to make ethical decisions.

The ethical climate of an organization is a system of ethical values that exist within an organization (Budisusetyo, Subroto, & Solimun, 2018). The ethical climate of the organization, or the ethical environment within an organization, is composed of a variety of practices that are run by management and members of organization, and the values attached to them (Victor & Cullen, 1988; Budisusetyo, Subroto, & Solimun, 2018). The role of a leader plays an important role in influencing the final results of the ethical decisions of auditors through firm's performance management. The role of the leader is to take all the key decisions that could help directly in the accomplishment of tasks and attainment of set goals and along with this the leader also knows the effect of his decisions of the department as a whole (Wolverton, 1990; Shah, Hamid, Shaikh, Qureshi, & Pahi, 2016). Audit firm leader contributes inderectly to auditor ethical decision making by forming skepticism through internal discussion with the team, becoming a mediator between the audit team and the client management when resolving misstatements, maintaining performance management by motivating auditors, and providing independence form as a form to assurance the independence of auditor's opinion. Thus, the leader's job performance is the key indicator which improves the overall performance and enhances the competitive advantage of the organization (Shah, Hamid, Shaikh, Qureshi, & Pahi, 2016).

To sum up, the leader's performance is an important element in order to measure the organizational performance, especially when this performance is referred to leaders' attribution terms (Wall, et al., 2004). Therefore, it is necessary for audit team leader to monitor the ethical climate as a major component of an organization's culture so it can be used as a reference on auditor behavior in dealing with the internal and external environment (Budisusetyo, Subroto, & Solimun, 2018) so auditors will not easily fail to behave ethically.

LIMITATION

In the case of Enron, the situation has an impact towards accounting profession. The rise number of clients who can rule the auditor's opinion given to the company make certain audit firm's image worse. Thus, trust in accountants and auditors has decreased along with the many other auditing scandals on behalf of the auditor's opinion. It is important for auditors to maintain independence from the opinions given to clients. To make this happen, audit firm needs to contribute to maintaining the firm's performance management so that auditors can make ethical decisions. In order to contribute, firm's leader must be able to make decisions for the firm he leads and attain a set of goals so that the decisions will have an impact on the firm as a whole.

Based on the case made by client's unethical behavior, author needs to conduct interview with auditor in order to find out what improvements need to be applied in audit firm performance management in contributing to auditors' ethical decision making. Therefore, we proposed that (a) audit firm leader should provide more external motivation apart from internal motivation which mainly related to promotional and marketing issues, (b) audit firm leader should involve more in regular audit team discussion, so skepticism formed becomes more concentrate, (c) audit firm leader needs to assessing the control environment routinely because it might provide the auditor with good insight regarding the control environment, (d) to minimize miscommunication and differences in perspective between auditors, it is important for the firm to have some team building activities for all employees with the aim of eliminating existing boundaries between them, (e) audit firm should generate the use of the video transmission technology for document inspection in order to minimize material

misstatements, this is intended to enable the auditor to make sure that the documents were not altered before being sent through any kind of electronic means.
Nonetheless, the author realizes some limitations of this research. First, this research consists more theoretical reviews than practical studies, although the author conducted interview to obtain data for this research. Second, due to the short time for completion of the research we did not have enough time to review all the information available and conduct more interviews. The time limitation indeed affects the accuracy of the findings due to the lack of interviewees. Another limitation is that the interviewee in this study came from Jakarta, Indonesia and it could be that differences in region and culture make auditors' behavior different from region to region. Thus, future research is needed to compare the perception of auditors in each region for more accurate results, and this may become a topic for further research.

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