

## The Role of Audit In Small And Medium Enterprises

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### Abstract

*Small and Medium Enterprises (SMEs) play a significant role in supporting the economic development of countries, including Indonesia. In 2019, SMEs has reached 63,95 million units which took over 99,62% of all businesses in Indonesia. SMEs also have contributed 61.79% to Indonesia's Gross Domestic Product in 2020, hence making them an important contributor to the country's economic growth. However, SMEs hold some weaknesses compared to large and modern businesses which its limited financial condition and difficulties when applying for funding to the bank due to their lack of proper reporting financial statements in accordance with the accounting standards. In order to resolve this issue, the role of independent auditors holds essential part in making SMEs more bankable by auditing their financial statements. Therefore, the financial statement of SMEs will be more reliable so that the bank will approve SMEs credit application.*

**Keywords** SMEs, Financial Statements, Audits

### INTRODUCTION

Small and Medium Enterprises (SMEs) play a significant role in supporting the economic development of countries, including Indonesia. According to the Ministry of Cooperatives and SMEs (*Kementerian Koperasi Dan Usaha Kecil Dan Menengah*), the number of SMEs reached 63,95 million units in 2019 which took over 99,62% of all businesses in Indonesia. As of 2020, SMEs have contributed 61.79% to Indonesia's Gross Domestic Product (GDP) which is equivalent to IDR 8,500 trillion, making them an important contributor to the country's economic growth.

Apart from the SMEs we are familiar with, the influence of technology and the internet has enabled digital or online SMEs. A major factor contributing to the growth of digital SMEs was the COVID-19 pandemic, where it influenced consumers' shifting consumption patterns of goods and services from offline to online. With the presence of the SME sector, the economy by absorbing a lot of labor from the lower middle class, as well as reducing the unemployment rate in Indonesia. Taking into account how important SMEs are to Indonesia's economy, the government pays great attention to their development and improvement.

The study of (Suyono, Eko Farooque, Omar Al Riswan, Riswan, 2016) stated that SMEs in general are limited in both financial and non-financial resources. SMEs face financial problems as a result of a lack of capital and difficulties accessing sources of capital, while non-financial factors, such as low qualifications and education levels of managers and owners, weak business networks, etc., reduce their competitiveness in comparison to larger companies. This is because SMEs generally aren't able to provide financial statements in accordance with the accounting standards as part of the bank's lending criteria. In other words, SMEs aren't bankable. In order to resolve this issue, the role of independent auditors



in SMEs businesses are essential. A more reliable financial statement will increase the likelihood that a bank will approve a credit application for SMEs businesses. Therefore, the purpose of SMEs audit is to help SMEs overcome their weaknesses so that they will be able to become more bankable in the future.

Despite that, a large majority of SME's aren't interested in having their financial statements audited compared to large and modern businesses. It is commonly the case that SMEs require audit services when applying for credit from a bank. Banks are unlikely to trust information presented by SMEs without independent audits. Hence why, independent third parties conduct audits in order to render an audit opinion on, whether the financial statements presented by the client are fair. In order to obtain a favorable opinion from an independent auditor, SMEs must meet multiple criteria as prescribed by accounting and auditing standards. The biggest obstacle to SME success, aside from capital, is financial management because SMEs still use simple bookkeeping methods and ignoring standards. Because International Accounting Standards Board (IASB) are too complex for SMEs that don't possess resources as large entities do, the Indonesian Accountants Association (IAI) has designed Financial Accounting Standards for Private Entities (SAK EP) for use in financial statements by SMEs. Therefore, if an independent auditor audits the SME's financial statement, the SME must present financial statements in accordance with SAK EP.

## **LITERATURE REVIEW**

Using (Arens, Alvin A Elder, Randal J Beasley, Mark S Hogan, Chris E, 2015) as a reference, auditing is the accumulation and evaluation of evidence about information to determine and report on the degree of correspondence between the information and established criteria. In Indonesia, the criteria used are the Indonesian Financial Accounting Standard, or PSAK (Pernyataan Standar Akuntansi Keuangan). Auditing should be done by a competent, independent individual. In other words, the auditor is expected to understand the criteria used as well as know what types and amounts of evidence to gather. This will enable them to reach the proper conclusion after analyzing the evidence. An auditor must also possess an independent mental attitude. An audit is worthless if the individuals conducting it are biased when collecting and evaluating evidence.

Among the types of audits, there are several types that are suitable for SMEs. Assurance services improve decision makers' access to accurate information through independent professional services. Services of this type are valued because the assurance provider is independent and perceived to be unbiased. Business decision makers seek assurance services to ensure that the information they use to make decisions is reliable and relevant. With technology rapidly advancing, the demand for assurance services continues to grow, especially with the growth of real-time electronic information.

Attestation services are one category of assurance services auditors provide. Certified Public Accountants (CPA) firms provide attestation services in which they certify the validity of assertions made by other parties.

1. Audit of historical financial statements
2. Audit of internal control over financial reporting

3. Review of historical financial statements
4. Attestation services on information technology
5. Other attestation services that may be applied to a broad range of subject matter

American Institute of Certified Public Accountants' (AICPA) Accounting and Review Services Committee issues Statements on Standards for Accounting and Review Services (SSARS) for preparing, compiling, and reviewing financial statements. A review services provide limited assurance on financial statements without requiring evidence as a whole, as opposed to audit services. This means that the scope of the review is narrower and less thorough than an audit. Therefore, the review only provides analysis of the summary of findings and recommendations related to those findings. Whereas compilation of financial statements represents one of the lowest levels of service that an accountant can provide. A compilation service provides no expressed assurance and financial statements are prepared by presenting information obtained from clients in a financial statement format. In most cases, banks throughout the region accept compilations, which are commonly used by SMEs.

Review and compilation are the most suitable services for SMEs. As the second cheapest option for their businesses, a review takes less time than an audit, but more time and resources than a compilation. A compilation takes the least amount of time, which makes it the most affordable option for SMEs, although it is one of the least comprehensive methods. While audits tend to be more expensive than other methods of analysis and overview, they provide the most comprehensive and complete overview of financial statements. Engagements in compilation or review provide substantially less assurance than audits, requiring less evidence and being more cost-effective. This is more suitable for SMEs with lower credit ratings and smaller funding than large and modern businesses.

A study conducted by (Hasnah Haron Ishak Ismail Ganesan, Yuvaraj Zulhawati Hamzah, 2016) asserts that auditing is beneficial for SMEs because it reduces their risk and facilitates their access to capital. (Hasnah Haron et al., 2016) explained further that auditing helps prevent fraud in financial management by reducing the possibility of intentional errors. It is also one of the ways a company can convince the tax authorities that it has correctly carried out its tax obligations. A similar argument was made by (Arens et al., 2015), who argued that the purpose of an audit is to provide users with an opinion regarding whether the financial statements are fairly presented in all material respects, as determined by the applicable financial accounting framework.

## **IMPLEMENTATION METHOD**

Researchers collect research data and discussion results from previous researchers, a process known as qualitative research. Researchers reviewed journal articles and scholarly publications related to audits for SMEs using electronic search engines.

## **RESULTS AND DISCUSSION**

With SME's becoming an increasingly substantial part of Indonesia's economy growth, auditing their financial statements is crucial to ensure that they have accurate and reliable information. By doing so, bankers may be more likely to grant funding to SMEs. Auditing



goes far beyond simply reviewing financial statements. Compilation of financial statements also provides useful services to SMEs, which are intended to assist SMEs in improving as well as surpass and become large or modern corporations. This is consistent with (Ademi, 2010), (Festus et al., 2016) and (Suyono, 2022) research findings, where auditing financial statements is beneficial from multiple perspectives.

1. Government's perspective

A conclusion can be drawn from the Ministry of Cooperatives and SMEs data that SMEs are becoming an increasingly significant part of the country's economic growth. SME employment makes up 96.9% of total national employment, giving them the potential to alleviate poverty. These SMEs may be closely monitored by the government, especially those that provide urgently needed goods or services to the community. The government calculates corporate taxes based on their financial statements. According to the Directorate General of Taxes in 2020, only 2 million of Indonesia's 60 million SMEs are registered as tax payers and pay taxes. The low tax payments made by SMEs are due to several factors, including the fact that a large number of SMEs still struggle to prepare financial reports, thus falling short of fulfilling their tax obligations. In this way, the government will be able to compile accurate SME tax data if SMEs conduct a voluntary financial statement audit.

2. Consumer's perspective

Consumers contribute to a business by buying products or using their services. Information that can be considered reliable by the company can include the quality of the product, delivery speed, and the warranty offered by the company. SME auditors' reports serve as controlling statements that ensure SME products and services can be delivered on time to consumers so that it can fulfill its obligations to suppliers on time. Even though neither financial statements nor audit reports are directly read by consumers, audit reports can nevertheless bring visibility and transparency to the relationship between consumers and suppliers.

3. Creditor's perspective

An SME owner may approach creditors for funding if their own capital can't finance all SME activities. On the other hand, the creditor will charge interest on the loan. Interest rates are generally determined by the amount of the loan and the term of the loan. Due to the role creditors play in companies, all creditor requests are of concern to SME owners. Moreover, creditors must bear the risk of company defaults when lending to a company. When SMEs seek funding from financial institutions, they must establish their financial standing and gain the trust of creditors. As a result, audits serve as a safe intermediary between creditors and borrowers. By doing so, SMEs provide a reassuring level of confidence to lenders when they conduct voluntary financial statement audits.

4. Employee's perspective

The performance of employees who receive salary and other compensation from the company will contribute to the company's success. In cases where employees' pay is shaped by the company's financial performance, auditing can provide reliable data on employees' performance and contributions. By auditing the financial statements of the

company, employees can feel more assured that the chances of fraud in their salaries and compensation are reduced or eliminated.

The discussion above indicates that SMEs can benefit from a voluntary financial audit in a number of ways. Despite this, many owners of SME are still hesitant to audit and consider auditing to be an expensive process. The only time they do it is when the benefit is immediate, such as a bank guarantee. As a solution to this problem, the government can work with university experts to provide SMEs with information about the benefits of financial audits. The government can also collaborate with researchers and community servants from universities to allocate research and community service that can help make audits successful for SMEs. Then slowly SMEs will be able to form an environment where they are aware of the importance of preparing financial statements in compliance with applicable accounting standards, as well as the need for these statements to be audited by independent auditors.

## CONCLUSION

According to applicable accounting principles, the objective of an audit conducted by an independent auditor is to present an opinion on whether the client presents its financial position, results of operations, and changes in financial position fairly. It is the auditor's responsibility to ensure that the audit process complies with auditing standards. To successfully complete an audit according to the intended standards, the audit process must be well planned, and there must be sufficient auditor personnel involved in the process. SMEs, in particular, benefit most from review and compilation services, as they are most affordable. By auditing SMEs' financial statements, the quality of information presented in their financial statements will be improved and they will no longer face difficulties when applying for bank funding. In this way, auditing SME financial statements can contribute to resolving one of the main problems SMEs faces in running their businesses: inadequate capital. The bank will have more confidence in SMEs when they apply for funding if the financial statements of these businesses are audited. In other words, SME audits will be beneficial to SMEs when applying for bank funding.

The government, consumers, and employees can also benefit from SMEs conducting voluntary financial statement audits. Governments will have access to accurate data about SMEs' contribution to local governments as well as tax calculations from SMEs. SME business organizations will be trusted by consumers as transparent organizations. From an employee's perspective, transparency in compensation encourages employees to perform better as they receive salaries, bonuses, and other compensation. Moreover, it can give employees a sense of security that the possibility of fraud in their salaries and compensation has been reduced or eliminated. In the long run, good employee performance will contribute to the profitability of SMEs. To raise awareness of the benefits of audits for SME businesses in the long run, the government needs to continue socializing the issue. The problem can be solved by involving researchers and community service workers from universities. Having solved one of SMEs' problems, the government can now focus on solving others.



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