CHAPTER I

INTRODUCTION

1.1 Research Background

Financial reporting plays a vital role in economics world. Its primary purpose is to provide the relevant and useful information to the owners of a company. Financial report as a business language can explain the entity's financial performance in a period and the financial condition of the entity at a certain date. The purpose of financial statements in accordance with SFAS I (revised 2009) is to provide information about the financial position, financial performance, and cash flows of an entity. It gives the majority benefit for the users in making economic decision reports. Financial statement also shows the results of management accountability over the resources entrusted.

Financial reporting is needed by the users of financial report. There are two type of financial report users. The first user is from internal parties, they are manager and directors. Manager used the financial statement for managing the company, because it is easy for planning, decision-making, and others internal control based on the data report of the company. The financial report is needed to see the ability of the company to provide employee’s allowance. The second user is from external parties like investors, lenders, suppliers, and customer. In the investor side, the financial report is used for a decision making whether to increase capital, reduce or sell its shares. In addition, investors also need to assess the company's ability to pay dividend or profit sharing. For lenders, the financial report is used to see company’s ability to pay the financial liability and timeline of the payment. For suppliers, the financial report gives the information of the company's ability to pay short-term debt. Such informations will help the supplier to determine the amount of credit extended and terms.

The space between company and investors makes financial reports analysis crucial, because investors only see from the financial report performance. So, they can see the development and sustainability of their business. Generally, the owners of the capital is not a party that run the company. Therefore, to increase the confidence of the data presented in the financial statements, company requires the services of an auditor. Independent auditor is engaged to render an opinion on whether a company's financial statements are presented fairly, in all material respects and in accordance with financial reporting framework. To form the opinion, the auditor gathers appropriate and sufficient evidence, observes, tests, compares and confirms until reasonable assurance is gained. The auditor will forms an opinion of whether the financial statement is free from material misstatement, fraud and error. At the completion of the audit, the auditor may also offers objective advices to improve financial reporting and internal controls to maximize a company's performance and efficiency. Auditors are required to have independency because indepedency is their work is the most important thing for a public accounting profession. It aims the auditors are not easily influenced by many parties and report the real financial report performance objectively.

Based on Indonesian regulation of finance minister number: 17/PMK.01/2008 on service of public accountants in article 3 paragraph 1 "Provision of services of general audit of the financial statements of an entity referred to Article 2 paragraph 1 is executed by a CPA firm most 6 consecutive fiscal years and by a public accountant for a maximum of three consecutive fiscal year. Second, public accountants and public accounting firms can receive the general audit assignment for clients back as referred to Article 1 after 1 financial year that do not provide services general audit of the client's financial statements. Because of the liability of the auditor rotation, the behavior of the company arise auditor to perform the switching. This regulation is updated on Indonesian republic of government regulation number 20, 2015 about the practice of public accounting services. This regulation is replace by Indonesian republic of government regulation Number 20, 2015 about the practice of public accounting services. In chapter V (the limitation of the audit service) article 11 paragraph 1 explains that audit services of historical financial information referred to in Article 10 paragraph 1 A letter to an entity by a Public Accountant is restricted to a maximum five years of consecutive fiscal. In paragraph 2, the entities referred to paragraph 1 hall that consists of industry in the capital markets sector, commercial banks, pension fund, the insurance company/reinsurance or State-owned enterprises. In paragraph 3, restrictions on the provision of audit services on the historical financial information referred to paragraph 1 and 2 also applys to public accounting that are the associated parties. Next, in paragraph 4, Certified Public Accountants can provide audit services back on the historical financial information of the entities referred to paragraph 1 after two consecutive fiscal years does not provide such services.

Auditor switching in Indonesia should ideally be mandatory. In fact, the phenomenon of auditor switching in Indonesia shows some company switches the auditor voluntary. Auditor switching by voluntary causes some negative impact on the company, since the cost will be higher if the company changed auditors too often. Companies that switch the auditors will issue unnecessary costs incurred when the company was using the same auditor. As an example when the new auditor assigned on a client company, the first thing to do is to understand the client's working environment and determine the risk of an audit. For auditors who have not understand the current situation, the auditor will require higher start-up costs which can ultimately increase the audit fee. In fact, the auditors who carry out their job in the begining of the year have a high possibility of error. Another results of auditor switching is so often comes from the client side. The auditor who performs the audit assignment in the company's clients in the first year will interferre the employee. The auditor will ask all the questions about the companies that should not be done if the auditor has not switched (Pratitis, 2012).

There are so many reasons why company switch the auditor. Based on research in Canada that conducted by Fontaine and Letaifa from University of Quebec in Montreal (UQAM) on 2012 the client value relationship such as communication of trust and also audit fees influenced the company changes the audit firm. Interestingly, prices become more important when communication and trust were absent. Client also told that value auditor independence is also influenced.In fact, in Indonesia auditor switching by voluntary is high. This is shown by the data that shows from 98 manufacturing companies listed on the Stock Exchange that exist during the years 2013 – 2010, there were 45 companies that registered auditor voluntary switch. Thats means that nearly half of the companies that exist on the Stock Exchange for eight years (2003 - 2010) to switch beyond the provision of government auditors (Patitis, 2012).

This studies previously been investigated by Wijayani (2011) using data Non - Financial Company listed in IDX 2003-2009 years with titled "Analysis of Factors Affecting the Company in Indonesia to do audit switching". The results showed that the variables that significantly influence the auditor switching was the change of management and the size of the CPA Firm. While the other variables examined in this study as the audit opinion, financial distress, the percentage change in ROA, and the size of the client was not shown to influence the company's decision to perform the switching of auditors.

Further research by Sudarno (2012) with the same topic, using Empirical Study On Manufacturing Company in Indonesia Stock Exchange Period 2006-2010 showed the results of the variables that influence auditor switching was the size of CPA Firm and management turnover. While the other variables examined in this study such as financial distress, public ownership, and changes in the audit committee did not prove to affect the company's decision to change the public accounting firm. This also has been investigated by Pratitis, 2012 with the same title by identifying voluntary switching company that showed variable size CPA Firm affected the auditor switching. The size of the client and the financial distress did not affect the auditor switching.

The differences of the results from previous studies, here seen inconsistency variables that affect the auditor switching. Considering there are parties that support and against it, related to the independence of auditors in the issue of switching the auditors, Therefore researcher is interested to restudy whether the type of the public accounting firm, the size of the company clients, anaudit tenure, the changing of management and an audit opinion variables are still have influence on the auditor switching.

This research will be conducted in difference sector from previous researcher that analyze all financial sector company listed in IDX, with a longer period of time that is from 2010 to 2014 and include additional variables that never used by previous studies to give different empirical results. So, the title of this research is "An analysis of factors influencing auditor switching (Empirical Study on Financial Sector Companies Listed in Indonesia Stock Exchange 2010-2014)".

1.2 Research Question

From the background and motivation that explained previously, this study examined the relationship of the size of the public accounting firm, size of clients, audit tenure, the change of the management and audit opinion with an auditor switching. The problem formulations are:

1. Does the type of the CPA firm (Public Accounting Firm) influence an auditor switching?
2. Does the size of the company clients influence an auditor switching?
3. Does audit tenure influence an auditor switching?
4. Does the changing of management influence an auditor switching?
5. Does an audit opinion influence an auditor switching?

1.3 Research Objective

The purpose of this research in accordance with the background and the formulation of the problems, the purpose of the author of doing this research are

1. To obtain empirical evidence whether the type of the CPA firm influence the auditor switching.
2. To obtain empirical evidence whether the client size influence the auditor switching.
3. To obtain empirical evidence whether audit tenure influence the auditor switching.
4. To obtain empirical evidence whether audit opinion influence the auditor switching.
5. To obtain empirical evidence whether management changing influence the auditor switching.

1.4 Research Benefit

The benefits of this research are as follows:

1. For the Public Accounting Profession

To be a material information about the practice of public accounting profession auditor switching by the company.

2. For Academics

The result from this study are expected to give their views and insights into the development of auditing particularly regarding to auditor switching.

3. For Further Research

This research can be a source of reference and information to allow subsequent studies that concern the discussion of auditor switching.

1.5 Writing Systematic

1. CHAPTER I: INTRODUCTION

   This chapter discusses the background of the problem, the formulation problems, objectives and benefits of the research, as well as systematic writing.

2. CHAPTER II: A LITERARTURE REVIEW

   This chapter provides the theoretical basis is used, also discusses similar previous research and framework studies that describe the relationship between variables research and the research hypothesis.

3. CHAPTER III: RESEARCH METHODOLOGY

   This chapter will discusses the research variables and their definitions operational, population and sample, the type and source of data, methods of data collection, and data analysis methods.

4. CHAPTER IV: RESULTS AND ANALYSIS

   This chapter explains the description of the object, the entire process, and data analysis techniques to the results of testing the entire research hypothesis.

5. CHAPTER V: CONCLUSION

Contains the conclusions obtained from the results hypothesis testing, limitations in the study, and suggestions for further research.