

# CHAPTER I

## INTRODUCTION

### 1.1 Research Background

The management of a company need to present financial statement as a description of their job performance. The report of financial statement could potentially be influenced by personal interest of the company itself, while the third parties as the users of financial statement are very interested to get reliable financial statements. In general, a set of financial statement provides the reference to the financial position at a certain period, company's performance, and cash flow in a period that is intended for users of financial statement outside the company to assess and make decisions pertinent to the company. As a source of information, a financial statement must be presented in a compulsory, transparent and easy to understand (Guideline for The Preparation of Financial Statement and Bapepam Regulation No.VIII. G;2000). This is where the role of public accountant as an independent party to mediate the two sides (the agent and the principal) with different interests (Lee, 1993 in Damayanti and Sudarma 2007) which is to make an assessment and a statement of opinion towards the fairness of the financial statement.

In carrying out the audit process, public accountant has gain the trust from the client and the financial statement's users to prove the fairness of financial statement prepared by the client. Therefore, in giving the opinion about the fairness of the financial statement, the auditor must be independent towards the interest of the client, the users of financial statement, and also the interest of

public accountant itself. Independence is essentially the mind attitude of someone who is characterized by the approach of integrity and objectivity of his/her professional duties. This is similar with American Institute of Certified Public Accountant (AICPA) stated that independence is an ability to act based on integrity and objectivity. Although integrity and objectivity cannot certainly be measured, but both are essential for the public accountant profession. Integrity is a moral principle that is impartial, honest, also perceive and express the fact as it is.

On the other hand, objectivity is an impartiality in considering the facts, personal interest is not included in facing the facts itself (Mulyadi, 2002). In the regulation of Compartment Ethics in Public Accountant, it is stated that in performing their duties, members of the firm must always maintain an independence stance in providing professional services as stipulated in Professional Accounting Standards set by IAI (*Ikatan Akuntansi Indonesia*). The independent mental attitude must include independent in-fact and also in-appearance (Amani and Sulardi 2005). It is unsophisticated if the users of financial statement, regulator and other parties have always questioned whether the auditor can be independent in carrying out their duties. The hesitation about the independence becomes heavier because public accounting firm has been given the freedom to provide non-audit services to their clients.

Mautz and Sharaf (1961) in Nasser *et al.* (2006) believes that the long relationship can cause the auditor have a tendency to lose their independence. Auditors who have a long relationship with their clients tend to have high dependency and strong economic boundaries with the client. The higher economic engagement between auditor and their client, the higher possibility of the auditor

to let their client to choose an extreme accounting method. This concern can be proved by several cases of manipulation in reporting the financial statement happened in some well-known companies, such as Enron, Worldcom, Xerox, and etc. that ultimately led to bankruptcy.

Therefore, to maintain public confidence in audit function and to protect auditor's objectivity, through the series of provision, auditor is not allowed to have such a personal relationship with their clients that may arise potential conflict of interest. One suggestion to avoid those conflict is to have a mandatory rotation of auditors (AICPA, 1978a; AICPA 1978b in Nasser et al.,2006) because it can increase the auditor's ability to protect the public through the increasing of vigilance for any improper possibilities, improving the service qualities, and avoiding a closer relationship with the client (Mautz, 1974; Winters, 1976; Hoyle, 1978; Brody and Moscovice, 1998 in Nasser et al., 2006).

Indonesia is one of the countries that require the rotation of CPA firm and audit partners applied periodically. The government has set the obligation of auditor's switching with the issuance of Decree of Minister of Finance of the Republic of Indonesia No. 359/KMK.06/2003 article No.2 about "Public Accountant Service" (amended to the minister of finance decree No.423/KMK.06/2002). This regulation state that the provision of public audit services for financial statement in an entity can be carried out by CPA firm not more than five financial years in a row and by a public accountant not later than three financial years in a row. Recently, the regulation is updated and changed with the Ministry of Finance Regulation No.17/PMK.01/2008 with the obligation to change the CPA firm after six financial years in a row and by a public

accountant not later than three financial years in a row. The auditor's switch can be obligated (mandatory) or voluntary. A voluntary auditor switch is differentiated on the basis of which party is becoming the focus of attention. Voluntary auditor switch is more concern on the the client side. Conversely, if the change occurs on a mandatory basis, the main attention switch to the auditor. There are only two possibilities that could occur when a client replacits auditor voluntary, either the auditor resign from their duties or the auditor fired by the client.

There are so many reasons behind the company switch the auditor. Based on research in Canada that conducted by Fontaine and Letaifa (2012) from University of Quebec in Montreal (UQAM) the client value relationship such as communication of trust and also audit fees influence the company changes the audit firm. Interestingly, prices become more important when communication and trust were absent. Client also told that the value of auditor independence is also influenced. Wilcox (1952) in Widiastuty and Febrianto (2010) emphasize that independence is an auditing standard that is essential to demonstrate the credibility of financial statements which is the responsibility of management. He emphasize that if the accountant do not act independently, than the opinion provided will not give any additional value.

In fact, in Indonesia auditor voluntary switch is quite high. This is shown by the data that shows from 98 manufacturing companies listed on the Indonesian Stock Exchange during the years 2013 – 2010, there were 45 companies that registered auditor voluntary switch. That means that nearly half of the companies

that exist on the Indonesian 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 of non-financial company listed in IDX 2003-2009. The result shows that the variable sthat significantly influence the auditor switching are the change of management and the size of the CPA firm. While the other variables examined in this study such as audit opinion, financial distress, the percentage change in ROA, and the size of the client are not shown to influence the company's decision to switch their auditors. Meanwhile, this research will be conducted differently from the previous research in terms of business sector that is going to be the sample of research and also variables used in this research. The researcher will use type of audit opinion, audit tenure, CPA type as independent variables, company size as control variable, and audit switching as dependent variable in this research.

## **1.2 Problem Definition**

From previous studies, there are some variables that have been tested and give different results. Therefore, there is inconsistent conclusion of variables that affect auditor switching. Because of this inconsistency, the researcher interested to examine the relationship between the types of audit opinion, audit tenure, CPA type towards auditor switching. The problem formulation is: *Do types of audit opinion, audit tenure, and CPA type partially have an effect on auditor switching?*

## **1.3 Research Objectives and Benefits**

The purpose of research according to the background and the formulation of the problem are as follows:

1. To obtain empirical evidence whether type of audit opinion influence the auditor switching.
2. To obtain empirical evidence whether audit tenure influence the auditor switching.
3. To obtain empirical evidence whether the CPA type influence the auditor switching.

After knowing the background, problem identification, research scope and purpose of this study, the authors have several benefits i.e:

- a. For the researcher

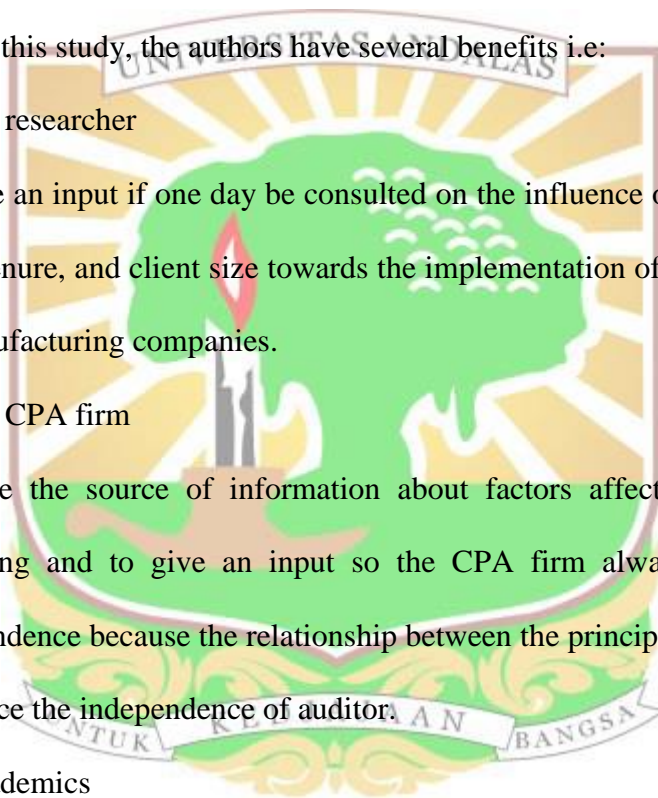
To give an input if one day be consulted on the influence of audit opinion, audit tenure, and client size towards the implementation of audit switching in manufacturing companies.

- b. For the CPA firm

To give the source of information about factors affecting the auditor switching and to give an input so the CPA firm always maintain its independence because the relationship between the principal and agent can influence the independence of auditor.

- c. For academics

It can provide information as input to add insight and guidance in order to conduct further research



## **1.4 Writing systematic**

### **CHAPTER I INTRODUCTION**

This chapter outlines the background issues that underlie this study, formulation of the problem, objectives and benefits of the research, scope of the study, a summary of the research methods, a review of previous research studies, and writing systematic.

### **CHAPTER II LITERATURE REVIEW**

This chapter provides the theoretical basis which contains theories which are used as a research platform, framework, and the formulation of hypotheses.

### **CHAPTER III RESEARCH METHODS**

This chapter contains a description of the research variables, population and sample, the types and sources of data, techniques for data collection, and data analysis techniques used in this study. In this case, the author uses quantitative research methods.

### **CHAPTER IV DISCUSSION**

This chapter contains the general description of the object of research, data analysis and hypothesis testing.

### **CHAPTER V CONCLUSIONS AND RECOMMENDATIONS**

Concluding chapter containing the conclusions of the research, limitations and suggestions.

