CHAPTER I

INTRODUCTION

1.1. Background of the Study

For public companies, it is mandatory to report and publish their financial reports and other reports. A financial report is one of the reliable tools of accountability for company management activities in certain period. It is used as a basis to determine company position and financial actions. It consists of information needed for both internal and external parties, such as management, shareholders, creditors, government, tax office, and other interested parties. Therefore, a financial report should show the actual circumstances of a company, so it can be used as consideration in making right decision (Pawitri & Yadnyana, 2015). According to Robbitasari & Wiratmaja (2013), financial report is the information source of operational activities and financial position presented by company's management.

Due to its existence needed and required by many parties, financial report should be credible and reliable. In terms of obtaining the fair, reliable, and easily understood financial information, it is necessary to apply examination procedures done by Public Accountant Firm or KAP through an independent auditor (Wea & Murdiawati, 2015). Public accountant firm is an entity that obtains permission from the minister, as a place for public accountants to provide services. The practice of public accountant is service activities that usually include performing examination and inspection, providing consultation, giving assistance, and representing clients in certain areas related to accounting. Thus, companies need auditing process to make their financial report trustworthy for other parties. In addition, in company perspective, a firm can identify the deficiency and obstacles of the management by conduct the process. Audit also can detect and disclose earning management and other kinds of misconduct by business managers or control shareholders (Lin & Liu, 2010). Public Accounting Professional Standard or *Standar Profesional Akuntan Publik (SPAP)* Indonesian Insitute of Certified Public Accountants or *Institut Akuntan Publik Indonesia* (IAPI) (2011) SA no 110 (PSA no. 02) states that auditing financial report by independent auditor has the purpose to state opinion of fairness in all material things, financial position, business result, changes of equity, and cash flow, which is in accordance with financial accounting standard in Indonesia. Audit report is one of the tools for auditors to state their opinion or if there are particular circumstances required, auditor will declare no opinion. Audit reports also indicate that the audit is conducted based on existing regulation and includes audit opinion whether the financial report presented fairly (Cohen & Leventis, 2013).

In performing an audit, independence is the most important matter for auditors. It is the main component that public accountants should nurture. Independent means auditors will not easily be affected by other parties in giving their opinion regarding the company report. An auditor should have integrity related to objectivity; it is usually called as independence in fact and independency in appearance (Christiawan, 2002). The independency of auditor will be lost if the auditor is involved in a personal relationship with the client, because it may affect auditor's opinion and mental in doing their job (Nasser et. al, 2006). Hence, in maintaining the independence of an auditor and reliability of the financial report, a company is required to do auditor switching. A company needs to prevent the long term of audit tenure; because long audit tenure can cause auditors to develop emotional relationship and loyalty with their clients, which in turn threaten auditor independence (Astrini & Muid, 2013). Another reason according to Damayanti & Sudarma (2008) is, the increased audit service requirement affecting the development of the public accountant profession in Indonesia thus the growth of public accounting firm is expected to spur a competition between firms, which in turn lead to the probability of companies to switch from one public accounting firm to others.

This research examines SOEs (State Owned Enterprises) since these companies play a significant role in state finances. It is well known that SOEs have three main mission, they act as an economic stabilizer, increases national economic growth and equity and as a business unit SOEs must be able to continue to earn profits, expand work opportunities and optimize the available resources (Damayanti, 2017). Indonesian state-owned enterprises listed on Indonesia Stock Exchange (IDX) have the responsibility to publish their audited financial reports in public every year. This obligation is a company's responsibility to public and nation. SOEs have all or part of their capital that comes from separated state assets; they are a national economic system, beside private and cooperative businesses (Lubis et. al, 2017). Since SOEs have an important role as the source of state revenue in terms of tax, income or dividend, choosing an independent auditor is vital. It is well known that SOEs finance is directly or indirectly related to the nation, thus they should maintain the independence of auditor since they have higher responsibility rather than private organizations. Limitation of audit tenure is one of the ways to prevent overlong interaction between auditors and clients that may interfere with their independency. Minister of finance decree No.359 / KMK.06 / 2003 that was renewed to Minister of Finance of the Republic of Indonesia Number 17 / PMK.01 / 2008 about Public Accountants Service, states that the audit service provision of financial report by public accounting firm is maximum six consecutive book years, and for the public accountant (auditor) is maximum three consecutive book years for the same client. Regardless of the regulation, there are companies that change their accounting firm before the specified period time ends. In this case, they do auditor switching voluntarily to find a suitable public accounting firm. SOEs are regulated under the law of Republic Indonesia number 19 year 2003 about state-owned enterprises and controlled by minister of sate-owned enterprises.

It is well known that, auditor and public accounting firm play important roles in a company and the independence of an auditor is the main key in doing an audit service. There is a huge case relating to auditor independence in one of the largest public accounting firms that happened in the early 2001s. The case is well known as Enron case in which Arthur Anderson–one of the big 5 accounting firms at that time, served as the auditor for Enron Company and manipulated the company’s financial report and the audit opinion. Besides, Arthur Anderson was involved in the company's daily accounting operational and it violated the independence and objectivity. Arthur Anderson allegedly committed obstruction of justice–destroying all potential evidences of Enron Company by shredding the documents, having figured out those documents would be used in Securities and Exchange Commission (SEC) investigation (Cunningham & Harris, 2006). One of the reasons why Anderson compromised with Enron is that Enron paid the audit fee higher than normal charge. This scandal is the reflection of how powerful auditor is toward a company. After the police investigated this case, there have been many Arthur Anderson clients decided to no longer use Arthur Anderson audit firm as an auditor for their companies. Arthur Anderson case has generated the standard formulation in business ethics, which is transparency of financial statement and audit rotation, called as Sarbanes Oxley (SOX) Act (Budisantoso et. al., 2018).

Auditor switching is the activities of changing public accounting firm or auditor done by a company. Auditor switching occurs because there are regulations that oblige a company to do it, and it is called as mandatory audit switching (Robbitasari & Wiratmaja, 2013). When the switching intention comes from the company itself, it is called voluntary auditor switching. The factors that affect the voluntary change may originate either from the client or from auditor. The causes of auditor switching from the client side are financial distress, unsuccessful management, changes in ownership or management, initial public offering, and more. The extant research has identified there are several reasons for companies to do auditor changes, including the intention to decrease audit fees, improve the credibility of annual reports, improve audit quality, lower agency cost, obtain a more favorable audit opinion, and more (Firth, 1999).

The research conducted by Wea and Murdiawati (2015), which studied the factors that influence voluntary auditor switching in manufacture companies listed on IDX found that management changes, financial distress, public accounting firm size, and client statistic size influence auditor switching. Meanwhile, changes of Return of Asset percentage and audit opinion do not influence auditor switching. The result is in line with the research by Astuti and Ramantha (2014), who found that firm size positively affects auditor switching along with audit fee and going concern audit opinion. Pawitri and Yadnyana (2015) found that auditor reputation positively influences voluntary auditor switching. This result is contrasts with the related study done by Budisantoso, Bandi, and Probohudono (2018) and Astrini and Muid (2013). They found that public accounting firm reputation has a negative effect toward auditor switching. The research done by Astuti and Ramantha (2014) found that company financial distress negatively influences auditor switching, which is in line with the study conducted by Astrini and Muid (2013).

Based on the explanation above, there is inconsistency related to the results of various variables used by previous researchers. Thus, the researcher intends to develop more about another aspect such as audit fee. In addition, the study on auditor switching in State-Owned Enterprises (SOEs) listed on IDX is rarely, so SOEs are chosen as the object in this research. The purpose of research is to find out the factors that can influence SOEs to do auditor switching. Hence four independent variables have been selected that have the probability of affecting audit switching, namely audit fee, public accounting firm reputation, company size, and company financial distress. Thus, the idea is developed into the research entitled **"An Analysis of the Impact of Audit Fee, Public Accounting Firm Reputation, Company Size, and Company Financial Distress toward Auditor Switching".** This research will use State Owned Enterprises listed on the Indonesian Stock Exchange in the period of 2013 to 2017 as the object.

1.2. Research Problems

Based on the study background explained before, the problems that will be discussed in this study are:

1. Does audit fee influence auditor switching?
2. Does public accounting firm reputation influence auditor switching?
3. Does company size influence auditor switching?
4. Does company financial distress influence auditor switching?

1.3. Research Objectives

Having formulated research problems, there are four research objectives to be achieved:

a. To find out the influence of audit fee on auditor switching in State-Owned Enterprises listed on Indonesian Stock Exchange period 2013 to 2017.

b. To find out the influence of public accounting firm reputation on auditor switching in State-Owned Enterprises listed on Indonesian Stock Exchange period 2013 to 2017.
c. To find out the influence of company size on auditor switching in State-Owned Enterprises companies listed on Indonesian Stock Exchange period 2013 to 2017.
d. To find out the influence of company financial distress on auditor switching in State-Owned Enterprises companies listed on Indonesian Stock Exchange period 2013 to 2017.

1.4. Research Contributions

This research provides benefits theoretically and practically. Theoretically it would make a significant contribution to the field of accounting, especially auditing. Furthermore, it can be a reference for other researchers to conduct further research related to auditor switching.

Practically, companies may take advantage of the research findings, as they can be a reference in decision making related to auditor switching. This study is also beneficial for auditors in the sense that they can figure out audit fee, public accounting firm reputation, company size, and company financial distress influence auditor switching.

1.5. Systematics of Writing

This research paper consists of five chapters, which are:

Chapter I: INTRODUCTION

This chapter presents the research background related to auditor switching in SOEs and the factors that may affect it. Besides, research problems, research objectives, research contributions, and systematics of writing are also described in this section.

Chapter II: REVIEW OF RELATED LITERATURE

The second chapter presents theories on auditing together with reference to the research problems being investigated. In the end of the section, hypotheses formulation is presented based on literature review.

Chapter III: RESEARCH METHOD

The third chapter describes research method used in this research that includes the type of study, population, sample, data collection method, research variable explanation, and data analysis.

Chapter IV: DATA ANALYSIS AND DISCUSSIONS

The fourth chapter explains the results of data analysis along with the interpretation of the data included. Then, hypothesis testing is whether they supported or not.

Chapter V: CONCLUSIONS AND RECOMMENDATIONS

The last chapter provides conclusions, limitations, and recommendations of the study for further research relating to the topic.