

# **CHAPTER I**

## **INTRODUCTION**

### **1.1 BACKGROUND OF THE STUDY**

Every management in a company holds the responsibility in publishing the financial reports periodically. Financial reports contain important information regarding to the company's financial information such as the profit, the cash flow and other financial information. These reports are needed for several users such as government, investors, creditors, debtors, shareholders, public and others in making decisions. Most of the financial report users expect for fair and impartial assessment of the information presented by the company. However, due to several issues and the difference of information interest, public enthusiasm toward the financial reports has been declining (Deli, Fatma, & Syarif, 2015).

The difference of information interest between the management and the users is known as asymmetry information. In this situation, it needs an independent and competent intermediary in reviewing the published financial reports, which is public accountant. As public accountant is a profession that engaged in services, it is necessary for public accountant to have the ability to build trust towards the clients, users, and the public, especially in the midst of this tight competition. The financial reports are audited by public accountants, which are known as auditors.

Auditors are demanded to maintain the audit quality by performing an independent and objective services, especially when auditing the clients' financial reports. An audited financial reports are used to check whether there is any misstatement on the client's financial reports and their accounting system (Mariyanto & Praptoyo, 2017). The audited financial report may increase the reliability and the

objectivity of the information provided and may also minimize the risk in decision making process. Therefore, auditors have to maintain the quality of an audit such as the objectivity and the reliability of the audit report.

An audit is defined as a systematic examination process. This is the process of examining the objectivity of the audit report regarding the assertion and the accuracy of the report presented by the companies. Maintaining the quality of an audit report is one of the most essential processes in performing audit services. The quality of an audit report will affect the credibility of the presented financial reports and reduce the risk from the non-credible information. Audit quality can be effected not only by the internal factors but also the external factors. The external factor that can affect the audit quality such as the audit rotation, audit tenure, audit fee and audit specialization.

Audit rotation is one of the external factors that can affect the audit quality. Government has set several regulations regarding the limitation on public accountant services that obligate all company to change the auditor for some certain years (audit rotation). The purpose of this regulation is to overcome and avoid any future unethical actions done by either auditors or the clients. Indonesia has been enacting this regulation since 2002. Based on Government Regulation no 20 of 2015 article 11 about the working-length between the public accountant (auditor) and the client, it limits the public accountant firm to conduct the audit services on the same client with the maximum of 5 (five) years continuously. According to the research done by Kurniasih and Rohman (2014), client and auditor's long-term relation will affect the auditor's independency. However, it was opposed by the research done by Febriyanti and Mertha (2014), which proved that audit rotation has no effect on audit quality.

The length of auditor-client relation, which is known as audit tenure, will also affect the objectivity of the audit quality. As the audit tenure increases, it reduces the ability for auditor to detect fraud due to closeness level of their relationship. An auditor, who audits the same client in a long period of time, will tend to be more emotionally related and decrease the independency (Fitriany, Utama, Martani, & Rosietta, 2015). Based on the research done by Nurhayati (2015) and Panjaitan (2014), audit tenure have significantly affected the audit quality in the independency of the report. In addition, research by Kurniasih and Rohman (2014), proves that audit tenure negatively affects the audit quality.

The quality of an audit can also be affected by the audit fee. Audit fee is the fee that auditor will receive after performing the audit services. The amount of audit fees depend on the audit risk, the complexity of the service, the size of the public accounting firm, the level of expertise required to perform the service and other professional considerations (Putri & Rasmini, 2016). However, the amount of audit fee that a company paid the auditor are based on the auditor ability in detecting error. As the result, the amount may also affect the quality and the integrity of the audited report. The high audit fee will provide a better audit report quality and a better integrity of financial statement. On contrary, the low audit fee will provide a fair audit report depending on the fee that is agreed based on their terms (Puspita & Utama, 2016).

The auditor specialization is also one of the external factors that may affect the audit quality. According to Clinton and Anis (2014), specialist auditor has a better understanding and more knowledge regarding the client's business condition than non-specialist auditor because they perform the services in their expertise field. Specialist auditors are also more likely to detect errors that occurs in the financial statement than the non-specialist auditor.

According to Fitriany (2015), auditors will perform and provide better audit report if they are asked to perform audit services in their specialist field because specialization can improve the effectiveness in determining the reliability of the client's financial statements so that the auditor will have the ability to detect errors or abnormalities in the industry he audited, which may provide a better earning information.

Based on the background of study, the writer is interested in conducting further research with the title of **“ANALYSIS THE EFFECT OF AUDIT ROTATION, AUDIT TENURE, AUDIT FEE AND AUDIT SPECIALIZATION ON AUDIT QUALITY”**.

## **1.2 PROBLEM LIMITATION**

Based on the background of study described above, the writer limits the problem of this research as follows:

1. This research is conducted on go-public companies listed in Indonesia Stocks Exchange (IDX).
2. This research uses data from companies in mining sector.
3. This research uses data from 2012, 2013, 2014, 2015 and 2016.
4. This research only uses the data with Indonesia currency (Rupiah).

## **1.3 PROBLEM FORMULATION**

Based on the background of study described above, the writer has identified several problems in this research, which are as follows:

1. Does audit rotation affect on the audit quality in mining companies listed at Indonesia Stock Exchange?
2. Does audit tenure affect on the audit quality in mining companies listed at Indonesia Stock Exchange?
3. Does audit fee affect on the audit quality in mining companies listed at Indonesia Stock Exchange?

4. Does audit specialization affect on the audit quality in mining companies listed at Indonesia Stock Exchange?

#### **1.4 OBJECTIVE OF THE RESEARCH**

The purposes of this study are to achieve several outcomes, which are as follows:

1. To analyze the effect of audit rotation on the audit quality in mining companies listed at Indonesia Stock Exchange.
2. To analyze the effect of audit tenure on the audit quality in mining companies listed at Indonesia Stock Exchange.
3. To analyze the effect of audit fee on the audit quality in mining companies listed at Indonesia Stock Exchange.
4. To analyze the effect of audit specialization on the audit quality in mining companies listed at Indonesia Stock Exchange.

#### **1.5 BENEFIT OF THE RESEARCH**

Upon the completion of this research, it is expected to bring several benefits for multiple parties.

##### **1.5.1 THEORITICAL BENEFIT**

This research is expected to bring several theoretical benefits which are:

- a. For the writer, this research may help the writer to gain more knowledge regarding the effect of audit rotation, audit tenure, audit fee, and audit specialization toward the audit quality.
- b. For the reader, this research will provide better understanding about the effect of audit rotation, audit tenure, audit fee and audit specialization toward the audit quality.

- c. For the upcoming researcher, this research can serve as an input for other writers who are interested in conducting related or similar research in the future.

### **1.5.2 PRACTICAL BENEFIT**

This research is expected to bring several practical benefits which are:

- a. For the auditor, this research may provide the information of how important is the audit quality to a company.
- b. For the company, this research may help the company to know the importance of the audit quality and to understand why audit rotation, audit tenure, audit fee and audit specialization are needed.

## **1.6 SYSTEMS OF WRITING**

The systems of writing in this research are divided into five chapters, which are as follows:

### **CHAPTER I : INTRODUCTION**

This chapter describes the background of this research, which discusses the basis outline about the audit quality. Limitation of the problem contains several conditions that limits this research. Problem formulation consists several questions regarding the audit quality. The objectives of this research are to analyze the effects of the independent variables which are audit rotation, audit tenure, audit fee and audit specialization to the dependent variable which is audit quality. This research is hoped to bring several benefits in both theoretical and practical. At the end of this chapter, the writing system



provides a brief summary about the materials discussed in each chapter of the research.

## CHAPTER II : LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

This chapter explains the theoretical background which contains some basic theories and terms used in the research such as agency theory which describes the relation between the principal and the agent. Some definition of the variables used were also being explained in this chapter. Prior research provides some relevant researches that have ever been undertaken by previous researchers. This chapter also formulates some hypothesis of the study regarding to the research. Framework of thinking provides a brief diagram or scheme designed regarding the research model.

## CHAPTER III : RESEARCH METHODOLOGY

In this chapter, it explains the research design used in this research, which is quantitative. The data used in this research is a secondary data which are obtained from the Indonesia Stock Exchange (IDX) through the website. The population and samples used in this research are taken by using purposive method. The variables and operational definitions are the description of the variables used in this method. Data analysis method is by using equation which is logistic linear.

#### CHAPTER IV : DATA ANALYSIS AND DISCUSSION

This chapter displays the general view of the research objects such as the list of samples used, the raw result of statistic tests and some of the hypothesis analyses test methods. This chapter also provides a brief description of the effects of the independent variables such as audit rotation, audit tenure, audit fee and audit specialization to the dependent variable such as audit quality in this research and a complete interpretation regarding the result of the research and hypothesis testing.

#### CHAPTER V : CONCLUSION

In this last chapter, it provides the conclusions of the research as well as the brief summary of the research results. It also provides some implications and recommendations related to this audit quality research. This research is expected to be useful for the upcoming researcher.