

CHAPTER I

INTRODUCTION

A. Background

In the era of globalization as it is today, audit activities are important. The business world becomes the usual thing to talk about because every time, companies are currently competing to present reports that have been audited to be trustworthy. Other than that, audit activities within the company are very important because they are considered as a benchmark in producing financial statement quality. Seeing the importance of audit activities within the company, then the role of an independent auditor (auditor) is very important in order to support the process of audit activities can run smoothly. Audit activities can run smoothly if an auditor can carry out his audit work in a manner good and responsible.

Auditors have a very important role in every company because, with the presence of auditors, the company will minimize potential actions to harm the company. An organization or company, there are two types of auditor those are internal audit and external audit. However, on this proposal, the writer focuses on external audit. An external audit is an audit performed by an outside auditor to verify the accuracy of the financial statements. The external audit is also a periodic examination of the books or records of an entity that is carried out by a third party independently. The function of external audit is to be tasked with examining the performance results of the internal auditor team whether the performance results of the internal auditors are relevant or not. The external auditor team consists of people who are not employees of the company. Moreover, the external team is present in the company because of

the "motion" / distrust of the shareholders on the performance of the internal auditor team, so this triggers the downgrading of the external auditor team. So the most important function of the external auditor is to check all company transaction data and check the company's financial statements and also check the performance results of the internal auditor team whether all reports are reasonable and relevant or not.

Audit quality seems inseparable from the general auditing standards listed in the auditing standard statement Mulyadi (2012), namely internal independence mental attitude, adequate technical skills and training, and professional skills. The mental attitude that is not influenced by any party does not depend on other people, and the auditor's honesty in considering facts and judgments objective and do not take sides in formulating and stating an opinion (Mulyadi, 2002). In the accountant's compartment ethics code, the public also states that auditors must always maintain an independent attitude in providing professional services as an asset in the professional standards of public accountants by IAI (Mulyadi, 2002).

In the modern era like now, the financial statements of a company are very easily accessible to its users. Therefore, the competition is getting higher. With such intense competition, companies must have good audit quality in order to attract investors. Many companies that have gone public are encouraged to use public services that have quality audit results, which is getting often public accounting firms are trusted to audit financial reports the company, the higher the reputation of the public accounting firm in society general (Kurniasih, 2014).

In Indonesia, case concerning audit quality by public accounting firms include the cases of PT Inovisi Infracom Tbk (INVS) is sanctioned by temporary suspension of stock trading

by the Indonesia Stock Exchange (BEI). This sanction is given because many errors were found in the company's financial performance report for the third quarter of 2014. The company also appointed a new public accounting firm to conduct an audit of the company's financial statements for the 2014 financial year.

The other case is the case of PT Hanson International Tbk - Ernst Young. Otoritas Jasa Keuangan (OJK) imposed sanctions on the partner public accounting firm of Ernst and Young (EY) because it was considered inaccurate in the presentation of the financial statements of PT Hanson International Tbk (MYRX). For this mistake, OJK has sanctioned to freeze the Registration Certificate (STTD) for one year. Deputy Commissioner for Capital Market Supervision I Djustini Septiana, in her letter, said that Sherly Jokom of the Purwantono, Sungkoro, and Surja Public Accountants Firm, was proven to have violated the capital market law and the code of ethics for the public accountant profession of the Institut Akuntan Publik Indonesia (IAPI). Sherly was proven to have violated Article 66 of the Capital Market Law. Paragraph A 14 SPAP SA 200 and Section 130 of the Code of Ethics for the Professional Public Accountant - Indonesian Institute of Certified Public Accountants. OJK assessed that this KAP had committed a violation because it was not careful and thorough in auditing PT Hanson International Tbk's financial statements for the financial year of December 31, 2016.

The independence of the auditor is very important owned by auditors in maintaining audit quality, where public accountants prefer prioritizing the public interest above the management's interest or the auditor's interest itself in making audited reports. Quality audit results can affect the image of the Public Accounting Firm itself, where audit quality contains

clarity information from the results of audits conducted by auditors on financial statements audited according to auditing standards.

In the history of Islam, Prophet Sulaiman has taught us about the audit like in surah An-Naml verse 20 and 21 :

وَتَفَقَّدَ الطَّيْرَ فَقَالَ مَا لِيَ لَا أَرَى الْهُدَّ هُدًى مَكَانِمْ أَ الْغَائِبِينَ

(QS. An-Naml verse 20)

لَأُعَذِّبَنَّهُ عَذَابًا شَدِيدًا أَوْ لَأَذْبَحَنَّهُ أَوْ لِيَأْتِيَنَّيَ سُلْطٰنًا مُّبِينًا

(QS. An-Naml Verse 21)

Meaning:

And he examined the birds and said: why did I not see the hud-hud, whether he was among those absent (QS. An-Naml verse 20).

Truly I will really punish him with harsh punishment or really slaughter him unless he really comes to me with a clear reason (Qs. An-Naml verse 21).

From the surah above, we can conclude that auditing has existed since the Prophet Sulaiman. It is that Prophet Sulaiman AS checked for look Hud-Hud, a pet bird the absence of Hud-Hud's can be subject to sanction by Prophet Sulaiman. In the next Verse, it is revealed

that Hud-Hud's absence was due to his trip to the land of saba. A country led by a Musyrik Queen of a sun worshiper. In Islam, audit has an objective by itself:

The objective of audit in Islam such as:

1. To assess the level of completion (progress of completeness) of an action
2. To correct (correct) an error
3. Give a reward (good reward) for the success of the work
4. Give punishment (bad rewards) for job failure

Financial accounting and reporting of a government unit provide financial information that is useful for making economic, political, and social decisions. To show the accountability and accountability of government officials for the tasks assigned to them. Financial information is also useful for evaluating managerial and organizational performance. The users of financial information for government units can be classified into five groups, namely:

1. Governing bodies,
2. Investors and creditors,
3. Resource providers,
4. Oversight bodies,
5. Constituents.

Moreover, the information needed is:

1. Financial viability,
2. Fiscal Compliance,
3. Management performance,
4. Cost of Services provided.

We can see from the Financial Accounting Standard Board (FASB) statement, Hendriksen (2001), that the function of financial reporting is to present the information used by those who make decisions about the economy of the company. In addition, the FASB also said that financial reporting should provide information that is useful for investors, both existing and potential investors, creditors, and other users within make rational investments, credit, and similar decisions (Hendriksen, 2001).

To meet the needs of these users, the financial information presented in the financial statements must be examined by an independent auditor. Furthermore, in this era of transparency and openness, it requires auditors to be more responsible for the results of the audits carried out, based on a code of ethics and professional standards. Contribution to the audit is to present accountability, as long as it provides an independent opinion, whether the financial statements of an entity or organization present fair results of operations and whether the financial information is presented in a form that conforms to established criteria or rules. There are many things that affect a good audit quality, such as audit company size, audit fee, client company size, audit tenure, and the effectiveness of the auditor.

Audit tenure has an important role in influencing audit quality. Audit tenure is the length of the auditor's engagement with the client company. How to measure it by calculating the length of time the auditor and client perform the engagement (Sinaga, 2012). Audit tenure generally cannot be separated from the lack of auditor independence which has an impact on the quality of the resulting audit. In an investigation conducted by the American Institute of Certified Accountants (AICPA), it was found that audit failure was three times more likely in the first two engagement years of the engagement compared to subsequent years.

Relationships between the auditor and the client that occur over a long period of time or more than one engagement have the potential to create a familiarity threat. In Indonesia, regulations regarding audit tenure are contained in the law of Republic of Indonesia No. 5 of 2011 concerning Public Accountants, which are then described in detail in the Government Regulation of the Republic of Indonesia No. 20 of 2015 concerning Public Accountant Practices. In this regulation, one of which is the provision of general audit services on the financial statements of an entity by a Public Accounting Firm and a Public Accountant for a maximum of 5 (five) consecutive financial years. Besides the audit tenure, there are some aspects that also have an important role in producing audit quality those are audit fee, audit company size, and client size

The audit fee is money or payment received by public accountants from their clients after carrying out their audit services. The amount of the audit fee depends on the risk of the assignment that carrying out by the auditor, the complexity of the services provided by the auditor, the level of expertise necessary to perform these services, the cost structure of the audit firm concerned (Andriani & Nursiam, 2018). Thus, if the company is more satisfied with the services provided by independent auditor, the company will be more loyal. This satisfaction arises because of the inner quality audits conducted by independent auditors. When the company loyal to the independent auditor, the company will still agree with the fee requested by the independent auditor.

Auditor also has a specialization. Auditor specialization is the specialty of auditors. It can be measured by how often the auditors have audit companies in the same industry. The other factor related to audit quality is auditor specialization. Nugrahanti (2014), states that the audit company size is increasingly doing its examination of similar companies. The Audit company

is an audit firm size that has specialist in the group of companies and the better the reputation of the audit quality. Auditor that has specialization in the same industry can understand more about the companies that being audited by them.

Thus, based on the background that has been described above by the writer, this study is a development from previous research conducted by Kafabih and Adibowo (2017) with the title "Analisis Pengaruh Client Size, Audit Firm Size, Dan Audit Fee Terhadap Audit Quality". In the previous study, the writer suggests adding a new variable that is audit specialization. Therefore in this study, the writer also decided to add some new variable such as auditor specialization and audit tenure that the writer use from the previous research that conducted by Suciati and Triani (2019) that have a title "Pengaruh Audit Tenure, Spesialisasi Auditor, Ukuran KAP Dan Workload Terhadap Kualitas Audit. If the auditor often audits companies in the same industry, the auditor can understand more about their financial statements and can better know about the shortcomings of the company's financial statements because they are used to it. In addition, the difference in this study from previous research is the proxy used for audit quality. Usually, the proxy used is discretionary accruals. However, in this study, the writer decided to used discretionary accrual abnormal working capital accruals Corbella et al. (2015) based on the (De Fond & Park, 2001). The discretionary accrual cross-sectional regression model of Jones (1991) is difficult to use globally because there could be fewer companies in the same industry (Francis & Wang, 2008). In this study, the writer decided to use the sample of the manufacturing companies listed on the Indonesia Stock Exchange (IDX) year 2017-2020. The reason for using the manufacturing company due to data homogeneity.

B. Research Scope

The aim of this study is to investigate whether the audit firm size, client size, audit fee, audit tenure, and specialization of the auditor can influence the audit quality of the manufacturing company that is listed on the Indonesia Stock Exchange (IDX) year 2017-2019 or not.

C. Research Question

1. Does the audit firm size have a positive effect on audit quality?
2. Does the client size have a positive effect on audit quality?
3. Does the audit fee have a positive effect on audit quality?
4. Does the audit tenure have a positive effect on audit quality?
5. Does the audit specialization of auditor have a positive effect on audit quality?

D. The Objective of The Study

The objectives of the study are as follows:

1. To find out whether the nature of audit firm size have a positive effect on audit quality.
2. To find out whether the nature of client size have a positive effect on audit quality.
3. To find out whether the nature of audit fee have a positive effect on audit quality.
4. To find out whether the nature of audit tenure have a positive effect on audit quality.
5. To find out whether the nature of auditor specialization have a positive effect on audit quality.

E. Significant of Study

- Theoretically

The researcher hopes this study can bring benefits for knowledge and related parties. The expected benefits of this study are as follows:

- a) This study provides developing research about determinant factors that affect Audit quality in the company.
- b) This study provides information that is expected to contribute as a reference for future research.
- c) This study provides information that is needed by the related party to know what is the factor that affects audit quality.

- Practically

- a) The results of the study can be used to increase knowledge, insight, information, and a description about audit effectiveness, audit firm size, client size, audit fee, audit tenure, and auditor specialization.
- b) This study expected for every related party to prevent asymmetry information in the financial report
- c) The writer also hopes that this study can be an indicator for the related parties to make a good audit quality and do not cheat on their duty.