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**Do Mandatory Audit Firm And Audit Partner Rotation
Really Improve Audit Quality?**
Comparison Between Pre And Post Regulation Period In Indonesia

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TOPIC: AUDITING

ABSTRACTS

Regulation about audit rotation in Indonesia is not only to regulate the rotation of audit partners, but also the rotation of audit firm. Regulation of audit firm in Indonesia creates quasi (unreal) rotation. This study aims to investigate whether the audit firm rotation regulation is required to increase audit quality because at present, many countries no longer apply the audit firm rotation. This study also examine whether the audit tenure and specialization affect the audit quality. The data samples used, are public companies listed on the period before (1999-2001) and after (2004-2008) the adoption of audit rotation regulation.

This research finds the quadratic relationship between tenure and audit quality, (not merely linear relationship as noted in previous research). Audit firm tenure at pre-regulation is negatively related to audit quality, but at post regulation convexly related to the audit quality (going down until 10 years and then going up). Audit firm rotation at the pre-regulation will decrease the audit quality, but after regulation doesn't affect the audit quality. Audit partner tenure at the pre-regulation concavely related to audit quality (going up until 3 years and then going down) while in the post-regulation, the relationship is convex (going down in the first 2 years and then going up). At pre and post-regulation period, audit partner rotation positively affects the audit quality. There is no the differences in audit quality between company doing real and quasi rotation. Based on these findings, we can concluded that the rotation regulation has not made any impact to audit quality. Hence, it is necessary to consider other regulation to improve audit quality.

These results indicate that audit firm rotation does not improve audit quality, so it should be considered stopped while audit partner rotation is still needed.

Keywords: Audit Quality, Real Audit Rotation, Quasi Audit Rotation, Audit Tenure

1. INTRODUCTION

1.1. Background

The rotation regulation has been implemented in Indonesia since 2002 in order to improve audit quality. This rule limits the engagement between a company and an audit firm for a maximum of five consecutive years and between a company and an audit partner for a maximum of three consecutive years. This rule was revised on 2008. The revised rule states, that an audit firm can serve a company for a maximum of six years. The regulation about rotation in Indonesia is an interesting case to investigate because Indonesia's rule is slightly different from many other countries. In Indonesia, the rotation is not only applied to audit partners but also to audit firms, whereas, in other countries the rotation is only applied to

audit partners. The regulation of the rotation in Indonesia creates a possibility for a quasi rotation that allows for an audit firm to change its name by changing its audit partners' composition; so that the audit firm employs more than 50 percent of the previous audit partners, to become a "new" audit firm. Therefore, all of the "new" audit firm's clients can be considered "new" clients, meaning that the audit firm can continue providing its services to their old clients. There are many audit firms that changed the audit partner composition to avoid the real rotation. According to Siregar et al. (2009), most of rotations after 2003 are unreal (quasi) rotation. Quasi rotation is the change of audit firm's name by changing its audit partner composition as if it performed the real rotation (actually there is no really change in the audit firm). On the other hand, real rotation is there is a real changed to audit firm that audits a company.

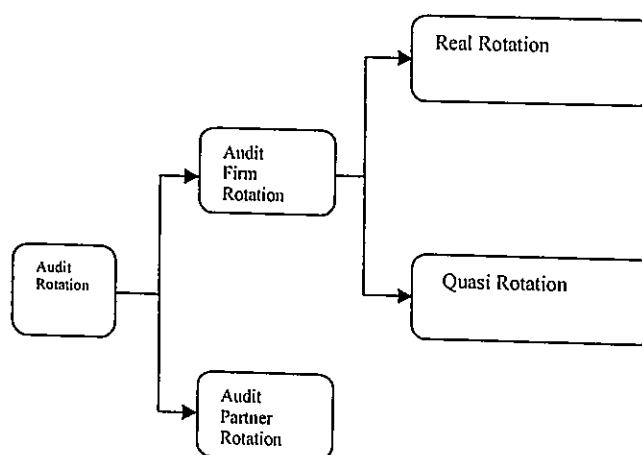


Figure 1. Type Of Rotation In Indoensia

Appendix 1 shows example of changes to the audit firm name in Indonesia. The name of audit firm change, but their international affiliation remained unchanged. Table 1 presents data on the rotation of auditors in Indonesia, in the period before and after regulation of rotation based on 1.846 firm- year observation, from 1999 to 2007. From 1.846 firm year observation, the data shows 426 audit partner rotation (2 before regulation and 424 after regulation period) and 376 audit firm rotation (34 before regulation and 342 after regulation).

From 342 audit firm rotation, 166 did real rotation and 176 did quasi rotation. The table shows that there is a significant increases in auditor rotation and audit firm rotation after the regulation period. The number of quasi rotation is more in number than the number of real rotation.

Table 1. Audit Rotation in Indonesia from 1999 until 2007*

Year	Audit Partner Rotation	Total Audit Firm Rotation	Real Audit Rotation	Firm	Quasi Audit Rotation	Firm
1999	0	11	11			
2000	2	9	9			
2001	0	14	14			
2002 (Regulation Starting)						
2003 (Regulation Starting)						
2004	125	106	47		59	
2005	111	84	42		42	
2006	120	123	48		75	
2007	68	29	29		0	
Total Before and After Regulation Period (1999-2007)	426	376	200		176	

Sources: Siregar, Fitriany, Wibowo, Anggraita (2009)
*Based on 1.846 firm-years observation

The impact of audit rotation and tenure to the audit quality remains controversial. Proponents of rotation argue that rotation increases independency. Gavius (2007) shows that the long-term relationship between auditors and clients triggers dependency problem, thus the rotation is required to create independence. Opponents of rotation argue that rotation decrease competency, since rotation requirement causes audit risk, a below standard audit implementation, because new auditors have not comprehensively understood their clients. St. Pierre and Anderson (1984) find that many audit failures and legal issues occur in the early years of audit engagement.

The relationship between audit tenure and audit quality also remains controversial. This relationship continues to split the opinion of the average Indonesian cliental. Many believe that the longer the audit tenure, the lower the audit quality (negative correlation); while others believe, the longer the audit tenure, the higher the audit quality (positive correlation). The negative correlation is supported by Davis et al. (2002). They illustrate that

the longer the tenure, the audit quality is lower due to the closer relationship between auditors and management. This closer relationship creates more flexibility for the management to produce financial statements in the auditors' favor. The positive correlation is supported by Geiger and Raghunandan (2002). They show that most audit failures occur in the early years of the audit engagement. Thus, the longer the audit tenure will improve the audit quality. Carcello and Nagy (2004) also find that the fraudulent financial statements often occur in the first three years of the audit engagement. When the audit tenure is longer, auditors will understand the firm with more comprehension. Therefore, fraudulent management can be prevented and reduced, and the audit quality improves.

Most research investigating the relationship between audit tenure and audit quality hypothesize a linear, positive or negative, relationship. This research suggests a quadratic relationship (concave or convex) between audit tenure and audit quality. This implies that there is an optimum point in providing audit services. Before reaching the optimum point, audit tenure can be positively (or negatively) correlated with audit quality. After reaching the optimum point, audit tenure can be negatively (or positively) correlated with audit quality. Wibowo and Rosietta (2009) examine the nonlinearity relationship by using an earning surprise benchmark as a proxy to the audit quality. However, they have not proven the significance of a nonlinearity relationship. Fitriany and Wibowo (2009) use a discretionary accrual as a proxy to the audit quality. They show the concave quadratic nature of the relationship between audit tenure and audit quality. Siregar et al. (2009) finds the quadratic relationship for audit quality to be measured by discretionary accrual. However they do not consider whether the tenure is real or quasi. Davis et al (2009) examines the quadratic relationship between audit tenure and discretionary accrual, which are conducted by firms for meeting and beating earning forecast in the period before and after the Sarbanes Oxley Act (SOX). Davis et al (2009) conclude that in the period before SOX, audit tenure and earning management possess quadratic relationship. However, in the period after SOX, the quadratic relationship is not proven.

Moreover this research will also investigate whether there are differences on audit quality between real and quasi audit firm rotation. This research contributes to the academic literature by developing a nonlinearity relationship theory. This research also provides inputs on Ministry of Finance and Indonesian Public Accountants Association to improve the regulation of the public accounting services in Indonesia, specifically in maintaining the public accountants' independence and competency. Finally, this research makes contributions to other countries that implement regulation on audit firm rotation.

This research finds that audit firm tenure at pre-regulation is negatively related to audit quality, but at post regulation convexly related to the audit quality. Audit firm rotation at the pre-regulation will decrease the audit quality, but after regulation doesn't affect the audit quality. Audit partner tenure at the pre-regulation concavely related to audit quality while in the post-regulation, the relationship is convex. At pre and post-regulation period, audit partner rotation positively affects the audit quality. There is no the differences in audit quality between company doing real and quasi rotation. These results indicate that audit firm rotation does not improve audit quality, so it should be considered to stopped while audit partner rotation is still needed.

The remainder of the paper is organized as follows. Section 2 describes theoretical framework and hypotheses development. Section 3 describes empirical models, data, and sample selection. We present our findings in section 4 and conclude in section 5.

2. THEORETICAL FRAMEWORK AND HYPOTHESES DEVELOPMENT

2.1 Agency Theory and Audit Quality

Jensen and Meckling (1976) explain the contractual relationship between owner and manager. According to the contract, the manager should work as delegated by the owner. However, the manager does not necessarily act in the best interest of the owner due to the manager's own self interest. One factor causing this is moral hazard. This occurs because there is asymmetric information between manager and owner. Therefore, an independent third party is required to address this issue. An external auditor will issue the

audit option fairly about the financial statements produced by manager. The use of an independent external auditor should decrease the agency cost (Jensen and Meckling, 1976; Watts and Zimmerman, 1986).

Stewardship hypothesis (Watts and Zimmerman, 1986) states that financial statements and auditor reports are required to examine the faithfulness and reliability reports produced by manager, and choose an auditor that creates good steward image for the manager.

On the other hand, according to the moral hazard hypothesis, manager tends to maximize his/her own wealth by sacrificing owner's wealth. The manager tends to choose an auditor that can provide more flexibility to select more favorable accounting methods as well as issue a more favorable audit opinion.

The agency conflict comes from institution mechanism. An auditor is engaged by management to perform audit service for shareholders' interest; however, an audit service is paid by the management (Gavious, 2007). This creates conflict of interest that an auditor cannot avoid. This institution mechanism makes the dependency of auditor to his/her client.

Palmrose (1984), Healy, and Lys (1986) state, that the audit quality is a primary indicator in selecting an auditor. Therefore, audit service quality rendered to client is a major consideration to select an auditor. Consistent with agency theory, firm management wants to satisfy investors' interest by selecting an auditor who can reflect a good image for the management from the investors' point of view.

On the other hand, there is agency problem from the auditor's point of view. The auditor's interest is maintained by accommodating clients' expectations, especially long-term clients. This is intended to guarantee the continuity of the audit engagement so that the auditor's revenue is guaranteed. An incentive to work with dishonest management is triggered by the relationship. Therefore, from an economic point of view, long-term audit engagement will trigger a closer relationship and loyalty between auditor and client. This will decrease the auditor's objectivity and the auditor's independency. The problem is when

the auditor is retained for a long time; the auditor will become too comfortable so that the auditor's objectivity will be distracted (Mautz and Sharaf, 1961).

However, an auditor should consider lawsuits and reputation risk in maximize auditor profitability (Reynold and Francis, 2001). Audit failures can lead to a regulatory sanction that damage the auditor's reputation. The regulation plays a role to protect the public interest by issuing policies and rules to maintain the audit quality.

2.2. Conditions Affect Issues of Audit Firm Rotation

The ultimate question about mandatory audit firm rotation is whether such policy enhances audit quality, and if so, at what cost? Operationally, the primary audit quality question is whether such a policy will lead to more independent auditors performing better audits by either detecting or reporting material misstatements in the financial statements, or whether the constant rotation of audit firms will result in inferior audit performance. Arel et al. (2005) stated that there are three related conditions that affect issues of audit quality and audit firm rotation: (a) Closeness to client management; (b) Lack of attention to detail due to staleness and redundancy; and (c) Eagerness to please the client. The following is their explanation.

a. Closeness to Management

Why audit firm rotation might be the answer. The nature of auditing requires that auditors interact extensively with their clients. Long-term relationships may result in a troublesome degree of closeness between the management and the auditor. Andersen auditors and consultants were given permanent office space at Enron headquarters and dressed business-casual like their Enron colleagues. They shared in office birthdays, frequented lunchtime parties in a nearby park and weekend fundraisers for charities.

When a contentious issue arises, this close relationship may create a conflict of interest for the auditor that can adversely affect the audit process. The auditor could closely identify with the management's perspective and not exhibit sufficient professional skepticism.

A study released in 2003, *GAO Kills Mandatory Auditor Rotation* (Fulcrum Financial Group), found that the average auditor's tenure for Fortune 1000 companies is 22 years—and it would have been much higher except for the demise of Andersen. Also, 10% of the companies in the study were found to have had the same auditor for 50 years, with the average tenure of this group being 75 years. In addition to effecting the audit process, close auditor-management relationships in many auditors being hired by former clients.

Why audit firm rotation might not be the answer. Even if one accepts the existence of a potential personal closeness to management as a problem, an auditor rotation may not solve the problem. An auditor must be able to gauge when the client is not revealing all available information, and this often comes from knowing the client and its management. Auditors from a new firm are faced with a "getting to know each other" stage and are unlikely to create the necessary open, respectful professional relationship that builds over time. The close relationship contributes to knowledge-sharing and is critical to the audit process.

A close auditor-management relationship may also not present a problem if the auditor can remain objective during the audit process and provide a reliable opinion on the company's financial statements. An auditor's independence, integrity, and expertise are all necessary, but are not sufficient conditions for achieving auditor reliability. Even though an auditor's independence may appear to be compromised, as in the case of a close relationship with management, he or she can still provide an objective and reliable opinion on the financial statements if he or she possesses the expertise needed and exhibits strong integrity. The audit committee can help by serving as a mediator in financial reporting disagreements between the auditor and management.

b. Staleness and Redundancy

Why audit firm rotation might be the answer. Auditors may become stale and view the audit as a simple repetition of earlier engagements. This staleness fosters a tendency to anticipate results rather than keeping alert to subtle but important changes in circumstances. Auditors returning to an engagement rely on prior-year workpapers to help plan the audit, set the budget, and provide valuable information needed for the current-year audit. Many prior-year schedules are used to develop current-year information. But a problem is created when auditors, especially less-experienced staff, overly rely on these papers. This problem is likely to be

exacerbated when the current-year auditor is reviewing his own workpapers from the prior year. Considerable behavioral research has examined this issue in an attempt to determine if such reliance is a significant problem.

This staleness in the audit process also affects (effects) the auditor's response to the subjective judgments made by the management; that is, repeat audit engagements allow auditors to rely on the judgments of prior auditors in deciding whether a management estimate is in accordance with GAAP. Mandatory audit firm rotation will periodically force new auditors to review the management's representation for compliance with GAAP and may force the management to adopt more conservative accounting practices.

Why audit firm rotation might not be the answer. By performing the prior-year's audit, it often produces significant benefits that increase the audit's effectiveness. The familiarity the auditor has with a company helps provide a better understanding of the issues and a better appreciation for the changes that have taken place from one year to the next. Given the complexity of today's many corporations, it is difficult for an auditor to completely understand a company's business in a short period of time. Audit failure rates have been demonstrated to be higher when the auditors are new and have not yet developed the institutional knowledge necessary for a comprehensive audit. Rotation of personnel on an engagement typically occurs within a firm as individuals receive promotions, retire, or move to other clients.

In addition to the effectiveness issue, returning to a prior engagement also provides added efficiency. The auditor is not starting from scratch, the company is familiar with what the auditor will be asking for, and there is less interruption to normal business. Many carryforward schedules are actually needed as part of the audit, and a new auditor will incur setup costs, even if previous workpapers are made available by a predecessor (e.g., the opening balance in the equipment account). Auditors take up a great deal of a client's time, creating both a financial and time-saving motivation to have a smooth and efficient audit.

c. Eagerness to Please the Client

The existence of a long-term "annuity" of possible future audit fees may result in a situation in which the obvious "business decision" is to please the client so as to retain the client. This may be the most compelling argument in favor of audit firm rotation.

Why audit firm rotation might be the answer. Knowing that another firm will take over the audit at some known future time increases the concern that the new auditors will detect any oversight, thereby adding to the pressure for the auditor to take a tough stand on any contentious issues. Indeed, research has shown in experimental conditions that the presence of an audit firm rotation policy increases the likelihood of accurate reporting by audit firms. Due to either a conscious or an unconscious bias, auditors in a nonrotation condition were more likely to agree with the client on a questionable accounting issue than were auditors in the last year of a rotation situation.

Why audit firm rotation might not be the answer. Even with mandatory firm rotation, a temptation remains to keep clients for the entire preestablished rotation period. If a difference of opinion occurs in any but the final year before rotation, there is the potential for losing the client "prematurely." Under mandatory audit firm rotation, auditors have the rotation period to make income. Any auditor with a short-term emphasis might be under even greater pressure to avoid losing the client. Thus, even with firm rotation, both a conscious and a subconscious desire to please the client during the rotation period can affect the audit process.

In addition, one may question the quality of service in the final year of the audit because the audit firm may be less motivated to serve a "lame-duck" client. Firms have already indicated that they would likely move their best and most experienced partners away from such clients, which could increase the probability of an error in the audit. Mandatory firm rotation will also require companies to select a new auditor, which in itself may lead to opinion-shopping in deciding which firm to hire.

2.3. The Impact of Audit Tenure to The Audit Quality

Mautz and Shraft (1961) argue that the relationship between the auditor and the client affect the auditor's independence because the auditor's objectivity decreases through time. The decrease of auditor's objectivity increases the possibility of identifying misstatement in the financial statements. The decrease is caused by several reasons. First, the longer the relationship, the more the auditor tends to support management. Hence, the auditor tends to have less professional skepticism and become more aligned with the management's perspective. Second, the longer the relationship, the auditor tends to be less sensitive to chances and fail to find new data and evidence to support the auditor's

judgment. This behavior can cause the auditor to fail in revising the improper judgment in previous years and might also fail in providing more appropriate judgment, which is suitable with the client-business dynamic. Last, the ability to retain client will be an incentive for the auditor not to argue with his/her client. The auditor tends to accommodate client's needs in order to get economic benefits by retaining the client.

According to previous research, there are two conflicting arguments about the relationship between audit tenure and audit quality. The first argument states that the period of audit engagement is negatively related to the audit quality. This is due to the closer relationship between auditor and client as the audit period is longer. This close relationship causes the auditor and the client to have a chance to compromise accounting and reporting method. This decreases the auditor's independence and thus, decreases the audit quality (Mautz and Sharaft, 1961; Kaplan, 2004; Gaviious, 2007; Dopuch et al., 2001; Chi et al., 2005).

The second argument states that the period of audit engagement is positively related to the audit quality. In other words, the longer the tenure, the better the audit quality. This positive relationship is due to several reasons as follows: (i) there are more audit failure and lawsuits in the early years of audit engagement. Thus, the longer the tenure, the audit quality will be better (St Pierre and Anderson, 1984); (ii) The new engagement increase the start-up costs thus, the audit costs will increase (Davis et al., 2002); (iii) Audit rotation causes audit risk, below standard audit implementation, because an auditor has not comprehensively understood his/her client (Beatty, 1989; Craswell et al., 1995).

Generally, those researches hypothesize a linear relationship (positive or negative) between audit tenure and audit quality. This research predicts that the relationship between audit tenure and audit quality is quadratic. Specifically, this research predicts that the audit quality increases as the audit engagement period is longer, until an optimum point, then the audit quality decreases as the audit engagement period is longer (due to decrease in the auditor independence).

Several researchers have developed such nonlinear relationship, such as, Davis et al. (2009). However, they use only one proxy for the audit quality (discretionary accrual). Wibowo and Rosietta (2009) use the earning surprise benchmark as a proxy of audit quality. However, they have not significantly proven the quadratic relationship. Fitriany and Wibowo (2009) and Siregar et al. (2009) find the nonlinearity with the only discretionary accrual acts as a proxy. This research tests quadratic model with more audit quality measurements (four proxies for earning quality).

This quadratic model is developed by starting from audit quality concept by De Angelo (1981a) who states that audit quality is the auditor's ability to detect the misstatements in the financial statements and report to the users of financial statements. The probability of detecting misstatements depends on the auditor's competency while how brave to report depends on the auditor's independence.

The relationship between the auditor's competency and the auditor's tenure is predicted to be positively related. The longer the tenure, the auditor will possess higher competency as the auditor gets a better understanding of the firm's internal control, accounting information system and specific risks. Fitriany and Rossieta (2009) find that tenure is significantly and negatively related to the discretionary accrual. In the first year of audit engagement, the audit quality is still low due to the fact that the auditor has not comprehensively understood client's situation. The longer the tenure (second or third year), the audit quality increases. However, in the fourth year, the impact of audit tenure to the audit quality is not significant.

The auditor who has not comprehensively understood client tends to depend on the estimation and information supplied by auditee (Gul et al., 2009). This is consistent with SPAP (2001) that states that business knowledge required by the auditor is acquired continuously and cumulatively. Because of the learning process, the additional knowledge in early years can be more or less than in the next years. Therefore, this research hypothesizes that the relationship between tenure and competency is either concave or convex, as depicted in figure 2.3.a and 2.3.b. Figure 2.3.a shows that the additional knowledge acquired

in the early years of the audit engagement is less than in the next years. On the other hand, figure 2.3.b shows that the additional knowledge acquired in the early years of the audit engagement is more than in the next years.

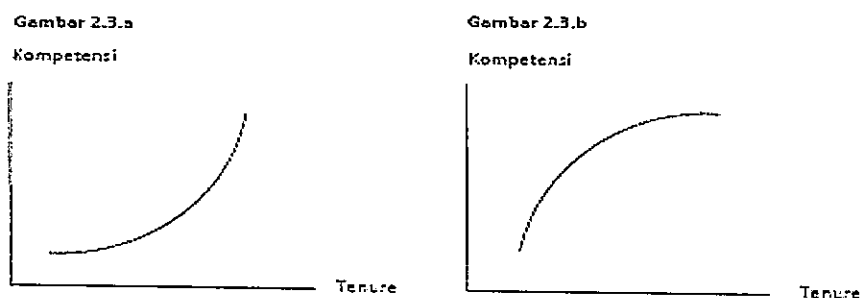


Figure 2.3 the relationship between tenure and competency

The relationship between tenure and independence is negatively hypothesized because the longer the tenure, the relationship between the auditor and the client is closer and thus, the auditor tends to be less critical / less independent. This is explained by Low-Balling theory (De Angelo, 1981a). In order to get and retain clients, the auditor charges lower fees in the early years of audit engagements. The audit fees will increase as the audit engagements become longer. Therefore, the auditor with lower tenure will be more tolerable to maintain his/her relationship with client so that the cooperation will continue and the auditor loss in the early years can be recovered. This phenomenon causes low audit and earning quality (Gul et al., 2009). Other research also finds that the longer the tenure, the independence tends to decrease (Gavious, 2007; Dopuch et al., 2001; Chi et al., 2005). This decrease differs among cases. In the early years of audit engagements, the decrease of independence can be faster or lower. This can be depicted in figure 2.4. Figure 2.4.a shows that the decrease of independence is slower in early years of audit engagement while figure 2.4.b shows that the decrease of independence is faster in early years of audit engagement

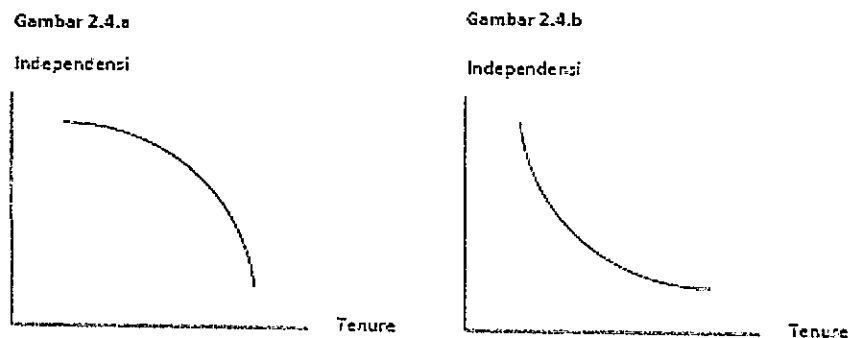
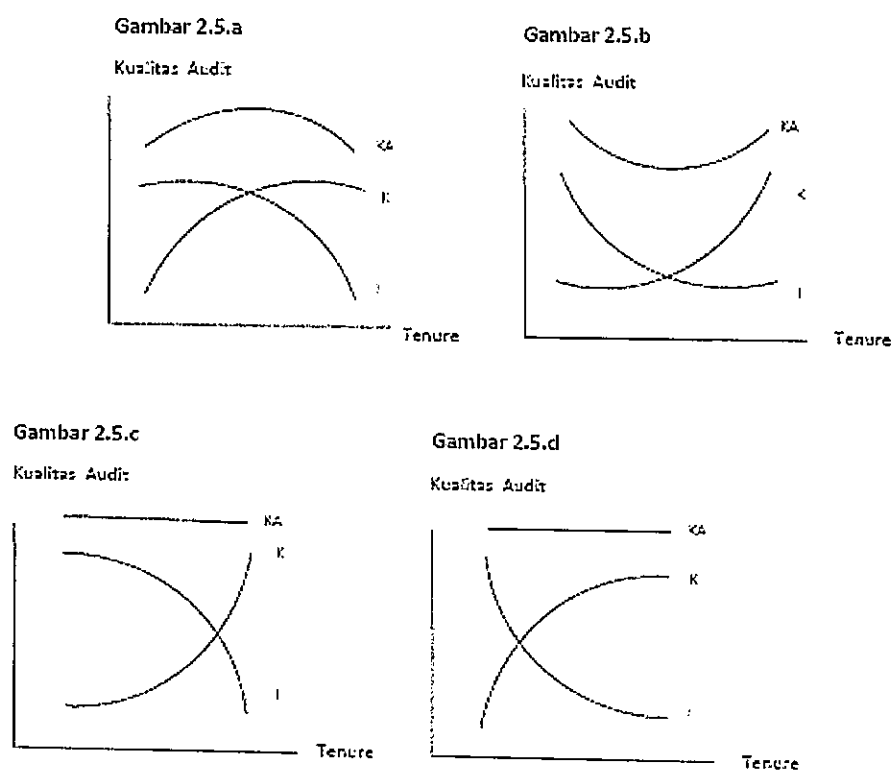


Figure 2.4. The relationship between tenure and independency

The audit quality is the combination between the auditor's competency and independence (De Angelo, 1981a). If figure 2.3 and 2.4 are combined, there will be various graphs like in figure 2.5. Figure 2.5.a shows that from the early years of tenure to the optimum point, the competency (K) increment is higher than the independency (I) decrement and thus, competency has higher tendency to affect the audit quality (KA) than independence. The audit quality will increase. After the optimum point, as the relationship between auditor and client is longer (this makes auditor and client understand each other so that independence issue more dominantly affected audit quality than competency), the audit quality will decrease. Therefore, the relationship between tenure and audit quality is concave as depicted in figure 2.5.a.

Other than depicted in figure 2.5.a, the relationship between tenure and audit quality can also be convex as depicted in figure 2.5.b. The shape depends on which one is more dominant between independence and competency. The shape also depends on the shape of independence and competency curve, whether it is convex or concave. Actually, the relationship between tenure and audit quality can be linear as shown in figure 2.5.c and 2.5.d. Those shapes occur when the competency increment equals the independence decrement. This research predicts that the relationship between tenure and audit quality is quadratic (either concave or convex).



KA : Audit Quality; K:Competency ; I :Independency

Figure 2.5. The relationship between tenure and audit quality

According to the explanations above, it can be hypothesized that the relationship between audit quality and tenure is quadratic (either concave or convex). The shape depends on the situation in that period, which one is more dominant, competency or independence. Therefore, the research hypotheses are as follows:

H1 : Audit tenure affects quadratically audit quality

This research will investigate the impact of audit partner tenure and audit firm tenure to audit quality in the period before (1999-2001) and after (2004-2008) regulation period.

2.4. The Impact of The Rotation to The Audit Quality

There are arguments opposing and supporting the rotation requirement. One research opposing the rotation requirement is St Pierre and Anderson (1984). They state that many of the audit failures and legal issues occur in the early years of audit engagement. Furthermore,

Davis et al. (2002) state that high frequency of auditor rotation will increase audit costs as a whole. This is due to the rotation, an accounting firm that is still new; still have to study his/her client because he/she does not have an adequate understanding of the company.

However, there are some proponents of the rotation requirement. For instance, Gietzmann and Sen (2001) find that even though the auditor rotation costs more, this increases the auditor's independence relatively more than the costs in several big clients.

According to the literatures above, the audit rotation can have positive (increase independency) or negative (decrease competency) impact. Thus, the hypothesis about the impact of audit rotation to audit quality will be a two-tails test. Thus the hypothesis is:

H2 : Audit rotation affect audit quality

This research will investigate the impact of audit partner rotation and audit firm rotation to audit quality in the period before (1999-2001) and after (2004-2008) regulation period.

2.5. The Impact of Real Rotation and Quasi Rotation to Audit Quality

In Indonesia, audit firm rotation can be divided into two types: real rotation and quasi rotation. The real rotation may occur due to changes in corporate management or shareholders of the client or prior audit opinion, etc. (Damayanti and Made, 2008). The real rotation may also occur due to mandated by the government. On the other hand, quasi rotation can be distinguished into two types: rotation in Big-4 firm and rotation in non Big-4 firm. According to the author's observation and interview with partner audit in Indonesia, when a quasi rotation occurs in a Big-4 firm, the replacing partner usually comes from the same audit firm. It is because these firms have abundant human resource which capable to be an audit partner, so the overall audit quality will not be much affected when a quasi rotation happens. In non Big-4 firms, many non Big-4 firms merger to anticipate rotation regulation. When a quasi rotation takes place in non Big-4 firms, the new partner usually comes from another audit firm, so the audit quality can be better, worse, or at the same with the preceding audit firm. But in a non big firm sometimes they only merger their audit firm's name, but not the audit firms operation. So, the audit quality maybe not effected because of

the merger. The Government requires audit rotation with aim to enhance the independence of the auditor, so the real rotation is expected to improve audit quality as compared to quasi rotation.

Based on that thought, researchers predict real rotation will give companies better impact in the audit quality. Consequently, the suggested hypothesis is:

H3: Real audit firm rotation have better impact to audit quality than quasi audit firm rotation.

3. Methodology

3.1. Measurement of Variables

A. DISCRETIONARY ACCRUAL

Accrual is used as a proxy for audit quality because high quality audit should mitigate more extreme management reporting decisions. Accrual can be used to identify these extreme reporting decisions. This is consistent with prior studies on audit quality (Francis and khrishnan 1999; Bartov et al. 2000; Geiger and raghunandan 2002; Myers et al. 2003; Francis and wang 2008). Prior research has searched for evidence of earnings management by examining the magnitude of abnormal accruals. Larger (smaller) abnormal accruals suggest more (less) earnings management (Velury and Jenkins, 2006). We use the magnitude of abnormal accruals, as measured by the Kaznic model to proxy for neutrality. To calculate normal accruals, the following cross-sectional model is used to generate coefficient estimates for each group of firms with the same two-digit SIC code and calendar year:

$$TACC_{it}/TA_{i,t-1} = \alpha_1(1/TA_{i,t-1}) + \alpha_2(\Delta REV_{it} - \Delta REC_{it})/TA_{i,t-1} + \alpha_3PPE_{it}/TA_{i,t-1} + \alpha_4\Delta CFO_{it}/TA_{i,t-1} + \epsilon_{it}$$

$TACC_{it}$ = total accrual year t, $TA_{i,t-1}$ = total asset at the beginning of year t, ΔREV_{it} = change in revenue between year t and t-1, ΔREC_{it} = change in receivables between year t and t-1, PPE_{it} = gross property, plant, and equipment in year t, ΔCFO_{it} = change in cash flows from operation between year t and t-1

The difference between actual accruals and expected accruals is attributed to abnormal accruals. The absolute value of abnormal accruals (ABNAC) is used as a measure

of earnings management. Using total accruals as a proxy for firms' endogenous accruals generating ability, Becker et al. (1998) find a positive association between abnormal accruals and total accruals. They explain that when a firm generates substantial accruals, management might choose to manage earnings because investors are likely to have trouble in differentiating the discretionary portion of accruals from the non-discretionary portion.

B. VARIABLE CONTROL

Several control variables and their expectations of results used in this study are discussed as follows.

1. Audit Specialization

A specialized auditor is an auditor who has extensive experience in auditing clients at certain industry. The experiences can increase auditor's knowledge about audit risks specified in that industry. This specialization can improve the efficiency and effectiveness in assessing the reliability of client's financial statements and estimations so that auditor will be able to detect errors or unusual items in his/her specialized industry. Therefore, a specialized auditor will be less likely to make mistakes compared to a non-specialized auditor (Solomon et al., 1999).

Compared to a non-specialized auditor, a specialized auditor will always protect his/her reputation by improving the compliance to auditing standards (Carcello and Nagy, 2004). A specialized auditor will be more confident in determining inherent risks and be more capable in detecting errors and financial fraud. Therefore, a company audited by a specialized auditor will produce better earning quality because of lower discretionary accrual and higher earnings coefficients (Balsam, 2003).

Therefore, this research predicts that there is a negative relationship between auditor specialization and accrual discretioner.

2. Client SIZE

Previous research has found that firm size negatively affects the amount of discretionary accruals on the company (Siregar, 2005). Lyss and Watt (1994) argues that the worse the condition of asymmetric information in an enterprise, the more freely managers to make decisions without being detected by the control system of the organization.

Additionally Lyss and Watt (1994) and Shu (1999) found a positive relationship between firm size with the risk of litigation so that motivate big companies to improve transparency in financial reporting, which means easier auditor to audit the company so that there is a positive relationship with audit quality.

On the other hand, Lobo and Zhou (2006) found that large firms have a higher chance to increase profits artificially because of the complexity of the business and operational users of financial statements difficult to detect such manipulation. The bigger the company, the more complex business and increasingly complex operational and information systems so that the possibility of auditors to detect earnings manipulation by management is reduced as a result the more likely the quality of audits performed will be less good.

Based on the above argument, in this study predicts that the size of the company could have a positive or negative effect on accrual management (quality audit). The variable firm size measured by natural logarithm of total assets.

3. GROWTH

Summers and Sweeney (1998) suggest that managers tend to manipulate the financial statements when the growth slows down to maintain the consistency of the company's growth. One measure used is the market to book ratio, which is the market expectations about corporate growth. We predicts that the growth of the company could have a negative effect on accrual discretioner. GROWTH variable measured by PBV.

4. LEV

DeFond and Jiambalvo (1994) show that firms with high debt levels have an incentive to artificially increase profits to meet debt covenants. However, on the other hand the existence of creditor also may be an alternative monitoring through external fund providers who have an incentive and the ability to monitor the activities of firms (Larcker and Richardson, 2006 in

Jiang et al., 2008). Becker et al. (1996) found that the level of debt is negatively related to the absolute value of discretionary accruals. In this study estimated that the level of debt could have a positive or negative impact on audit quality.

5. LOSS

LOSS reflects the company's financial condition. Companies that suffered losses have a greater incentive to make earnings management by doing big bath (Kallapur et al, 2008).

LOSS relationship with accrual manajemen predicted positive

6. CFO

CFO reflect the company's cash. Companies that have good cash conditions will have good earnings quality as well, and vice versa (Velury and Jenkins, 2006). Lobo and Zhou (2006), and Becker et al., (1998) suggest that firms with operating cash flow performance is good, has a smaller chance to artificially manipulate earnings. Conversely, companies with poor operating cash flow is more likely to manipulate earnings are artificially to send a positive signal for investors. In this study estimated that the CFO has a positive effect on accrual management.

7. BIG-4

Blokdijk et al. (2006) states that audit quality is a function of three factors of production, namely the quality of inputs, the intensity of the input and the available technology to transform inputs into outputs. The quality of the input indicated by the expertise, knowledge and decision-making in conducting the audit, such as human resources (O'Keefe et al., 1994). The intensity of the input is the number of hours worked auditors in conducting the audit process (Hackenbrack and Knechel, 1997). While technology is the auditor's audit programs, audit software, and other technologies that help the audit process. In this research, audit technology will be measured from the Foreign affiliate with KAP. KAP who have affiliations with the Big 4 will obtain audits and audit software programs as well as peer review of the Big 4 with better quality compared with other KAP. So the expectation of this research is a

company which is audited by KAP affiliate Big 4 will have the ability to detect earnings management better than the non big-4 affiliate.

3.2. RESEARCH MODEL

To examine the relation between audit firm rotation, audit firm tenure and audit quality, we examine the following model:

$$ABS_DAC_{it} = a_0 + a_1 FTENURE_{it} + a_2 FTENURESQ_{it} + a_3 FROTATION_{it} + a_4 SPEC_{it} + a_5 BIG4_{it} + a_6 LEV_{it} + a_7 GROWTH_{it} + a_8 SIZE_{it} + a_9 D_LOSS_{it} + a_{10} CFO_{it} + \epsilon_{it} \dots \dots (model 1)$$

Where,

ABS_DAC _{it}	absolut discretionary accruals as proxy of audit quality
FTENURE	real audit firm tenure, measured as number of continues years of accounting firm employment
FTENURESQ	real audit firm tenure squared
FROTATION	dummy variable, equal to 1 if there is audit firm rotation and 0 otherwise
SPEC	dummy variable, equal to 1 if the company is audited by specialized auditor (have > 10% market share in an industry, based on its client's total asset) and 0 otherwise.
BIG4	dummy variable, equal to 1 if the company is audited by Big4 and 0 otherwise
LEV	debt-to-total asset
GROWTH	price-to-book value
SIZE	natural logarithm of ending book value of total assets

To examine the relation between audit partner rotation, audit partner tenure and audit quality, we examine the following model:

$$ABS_DAC_{it} = a_0 + a_1 PTENURE_{it} + a_2 PTENURESQ_{it} + a_3 PROTATION_{it} + a_4 SPEC_{it} + a_5 BIG4_{it} + a_6 LEV_{it} + a_7 GROWTH_{it} + a_8 SIZE_{it} + a_9 D_LOSS_{it} + a_{10} CFO_{it} + \epsilon_{it} \dots \dots (model 2)$$

Where,

PTENURE	audit partner tenure, measured as number of continues years of audit partner engaged in the company
PTENURESQ	audit partner tenure squared
PROTATION	dummy variable, equal to 1 if there is audit partner rotation and 0 otherwise

To examine the whether real rotation have better impact to audit quality than quasi audit firm rotation, we examine the following model:

$$ABS_DAC_{it} = a_0 + a_1 RROTATION_{it} + a_2 BIG4_{it} + a_3 LEV_{it} + a_4 GROWTH_{it} + a_5 SIZE_{it} + a_6 D_LOSS_{it} + a_7 CFO_{it} + \epsilon_{it} \dots \dots (Model 3)$$

Where,

RROTATION	dummy variable, equal to 1 if there is real audit firm rotation, 0: quasi audit firm rotation
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3.3. Model Test

The model 1 and 2 are tested using balanced panel because balanced panel accommodates both cross section and time series variables. Panel data substantially can reduce omitted variables problem (Gujarati, 2003). Hausman test is performed to identify whether the model use random or fixed effect. We also do multicollinearity, autocorrelation and heteroscedasticity test. Model 3 is tested using using OLS (ordinary least square) which doing test of autocorrelation, heteroscedasticity and multicollinierity.

Multicollinearity often occurs in multiple regressions, which applies interaction variable. An interaction variable is an arithmetic multiplication from two or more variables. Therefore, an interaction variable will be highly correlated with another variable. In this research, centering method will be used to address the problem arising from multicollinearity due to interaction variable (Cronbach, 1987). In centering method, every variable is deducted by mean sample. Centering is performed only for variables, which have high Variance Inflation Factor (VIF). Multicollienarity can be identified from the correlation coefficient or VIF value from the regression. According to statistics principle, good high VIF value should be less than 10 (Gujarati, 2003). Eviews 6 is the econometric software used here. Since Eviews assumes two tail tests, the probability value is divided by two to perform one tail test.

3.4. Sample Data

For model 1 and 2, we use two observation period: year 1999 – 2001 to represents years before mandatary auditor rotation regulationand year 2004-2008 for years after the mandatary auditor rotation regulation. We exclude years 2002 and 2003, because those are the first years of the regulation implementation. For model 3 we only use data from post regulation period (2004-2008) as an observation period because the quasi rotation only happen on post regulation period .

This research uses companies that are listed on Indonesian Stock Exchange (BEI) from 1999 to 2008. It excludes financial companies (banks, leasing and investments corporations) because those companies have special financial statements structure so that their earning quality measurement does not equal with the one in other industries. Sample selection procedure is shown in table 2.a and 2.b. There are 309 firms years for model 1, 515 firms years for model 2 and 445 firms years for model 3.

4. Result

4.1. Descriptive Statistics

Table 3 and 4 present descriptive statistic of the sample. Table 3 shows that in pre-regulation period, audit firm tenure (TENURE) has mean 6.2 years, maximum 21 years and minimum 1 year. The mean is closes to maximum tenure regulation permitted by Ministry of Finance (MoF) which is six years. In pre-regulation period, only 9 percent of sample companies change their audit firm, most of the companies change only audit partner (32 percent). Companies which are audited by specialized auditor and non-specialized auditor are relatively equal (59 percent vs 41 percent). Most of the companies (86 percent) are audited by Big Four (Big Five) audit firms.

In the after regulation period (see table 4), real audit firm tenure is 6.93 years, minimum 1 year and maximum 20 years. The percentage of the sample companies which rotate both audit partner and audit firm increases compared with pre-regulation period (50 percent and 15 percent in the after regulation period vs 32 percent and 9 percent in the pre-regulation period). Companies which are audited by specialized auditor and non-specialized auditor are equal (50 percent vs 50 percent). Companies which are audited by Big Four (Big Five) audit firms decreased significantly compared with the pre-regulation period (57 percent in the after regulation period and 86 percent in the pre-regulation period). Subsequent specification tests indicate that multicollinearity, autocorrelation and heteroscedasticity do not drive our result.

4.2. The Impact of Audit Firm Tenure to The Audit Quality

Result for model 1 presented in Table 6. Results from sample data in the pre-regulation period is shown in column 1 while the results from sample data in the post regulation period is shown in column 2. For the pre-regulations periods, FTENURE is significantly positive but FTENURESQ is not significant. This indicates that in the pre-regulation period, the relationship between FTENURE and ABS_DAC (discretionary accrual) is positive. Since discretionary accrual is inversely related to the audit quality, we can conclude that audit tenure is negatively related to audit quality. It means that the longer the tenure, the lower the audit quality. This maybe occurs because of the closer relationship between auditor and client (this implies the decrease of auditor's independency) when the tenure is longer. This is consistent with Knechel and Vanstraelen (2007) who find the negative relationship between tenure and audit quality.

At post-regulations periods, FTENURE is significantly positive and FTENURESQ is significantly negativ. This indicates that in the post-regulation period, the relationship between FTENURE and ABS_DAC (discretionary accrual) is concave. Since discretionary accrual is inversely related to the audit quality, we can conclude that tenure is convexly related to the audit quality. This is shown in the figure 1A. The minimum point of the curve occurs when audit firm tenure is 10 years (the calculation is shown on table 5). This implies that audit quality will decrease until first 10 years of the audit engagement. After 10 years of audit engagement, the audit quality will increase. As the time required to improve the audit quality is quite long (approximately 10 years), the relationship between audit firm tenure and audit quality is actually negative. We can conclude that there is no difference between pre-regulation and after regulation period. Both show a negative relationship between tenure and audit quality.

4.3. The Impact of Audit Partner Tenure to The Audit Quality

Result for model 2 presented in Table 7, pre and post regulation are shown in coloums 1 and 2. For the pre-regulations periods, PTENURE is significantly negative and

PTENURESQ is significantly positive. This indicates that in the pre-regulation period, the relationship between PTENURE and ABS_DAC is convex (see figure 2A). Since discretionary accrual is inversely related to the audit quality, we can conclude that tenure is concavely related to the audit quality. This is shown in the figure 2B. The minimum point of the curve occurs when audit partner tenure is 3 years (the calculation is shown on table 6). This implies that audit quality will increase until first 3 years of the audit engagement. After 3 years of audit engagement, the audit quality will decrease.

Concave shape indicates that prior tenure reaches an optimum point, increasing tenure led to an increase in audit quality. This increase is in accordance with the theory of Zimmerman (1985) which says that competence has a greater influence (the increase in competence is higher than the decline of independence). The longer the auditor audit a company, auditors increasingly find out the effectiveness of internal control, accounting systems and the client's specific risk. This is consistent with Davis (2009) who found that the auditors will increase its competence if it works long on one particular industry, so getting familiar with the practices and the risks that are unique to each industry. After reaching the maximum point, the audit quality declined. This study found that the maximum point is at three years. Decline in audit quality after three years due to the increase in competence is smaller than the decrease in independence. The decrease in independence is due to long relationship of auditor and the client so the auditor's objectivity decreases. The decrease of this objectivity will increase the likelihood of failure to detect errors in financial statements. This finding is in accordance with the results of Davis et al. (2009) and Siregar et al. (2009).

At post-regulations periods, PTENURE is significantly positive and PTENURESQ is significantly negative. This indicates that in the post-regulation period, the relationship between PTENURE and ABS_DAC is concave (see figure 3A). Since discretionary accrual is inversely related to the audit quality, we can conclude that tenure is convexly related to the audit quality. This is shown in the figure 3B. The minimum point of the curve occurs when audit partner tenure is 2 years (the calculation is shown on table 6). This implies that audit

quality will decrease until first 2 years of the audit engagement. After 2 years of audit engagement, the audit quality will increase.

The relationship between tenure and audit quality in post regulation period differ with pre-regulation period. It may be due to in the pre-regulation period, rotation is natural, whereas in post-regulation period, rotation is not natural (mandatory).

It is estimated that the decrease in independence in the early years of audit was higher in post-regulation period compared with the decrease in the pre-regulation period. This is because of the three-year rotation rule. In the first and second year auditors seek to obtain assignment of clients so that auditors comply with client requests. This causes the quality of audits fell. After that, as it surely will be replaced, auditor must demonstrate a good audit quality because of his work will likely be further examined by another auditor. As Barbara et stated that knowing that another firm will take over the audit at some known future time increases the concern that the new auditors will detect any oversight, thereby adding to the pressure for the auditor to take a tough stand on any contentious issues. Indeed, research has shown in experimental conditions that the presence of an audit firm rotation policy increases the likelihood of accurate reporting by audit firms.

Another explanation of the decline in the independence in first two years is because many companies change audit firms because of regulation. Based on the theory of low-balling, to obtain and retain new clients, auditors charge lower audit fee on the early years of the provision of audit services. The fee of this audit will continue to increase with increasing period of engagement (DeAngelo, 1981). Thus, auditor which tenure is still low, they will be more tolerable for maintaining relationships with clients so that their cooperation can last long and auditors losses in the early years can be covered. This will lead to poor audit quality and low quality of earnings. (Gul et al. 2007). After the loss of auditor on the early years covered and auditors also have a more in-depth knowledge about the company, the auditors will feel more secure to be more independent and competent to limit the earnings management so that the the quality of audits will increase again.

4.4. The Impact of Audit Firm Rotation to The Audit Quality

Table 6 coloum 1 and 2 presents that at the pre-regulation period, ROTATION is significantly positive, but in the post-regulation period ROTATION is not significant. It means at the pre-regulation period, audit firm rotation causes an increase in ABS_DAC. Since discretionary accrual is inversely related to the audit quality, we can conclude that audit firm rotation will decrease the audit quality. But after regulation period, the audit firm rotation doesn't affect the audit quality. This result maybe due to in the pre-regulation period, the rotation requirement is not mandatory. Auditor changes is more due to a disagreement between the client and the auditor so that auditor chages causes a decrease in audit quality. The decrease may be due to new audit firm has not sufficient knowledge about client business and risks.

In the post regulation period, the rotation requirement is mandatory. Many audit firms exchanging their audit firms name. For a company that actually perform real audit firm rotation, the real rotation did not affect the audit quality. It's because rotation increases the independence, but on the other hand rotation decreased competence. For all therefore, the rotation does not affect the audit quality. This result is consistent with Fitriany and Rosita (2011) which found that audit firm size changes do not affect the quality of audits. This shows that the purpose of rotation to improve audit quality is not achieved.

4.5. The Impact of Audit Partner Rotation to The Audit Quality

In Table 7 can be seen that in the pre and post-regulation period, audit firm rotation negatively affect discretionary accruals or positively affect the audit quality. These results indicate that if there is audit partner rotation, audit quality is still high because auditor is not too close to the client. These results are in accordance with the findings of Hamilton et al. (2005) that the audit partner rotation led to a decrease in discretionary accruals.

4. 6. The Impact of Real and quasi Rotation to The Audit Quality

In order to test hypothesis 3, a test was conducted in companies doing audit firm rotation based on regulation then differentiated whether the company did the real or quasi rotation. In Table 8 can be seen that variable RROTATION is not significant. It means that there are no differences in audit quality between real and quasi rotation. Therefore, it have not been found evidences showing the differences between real and quasi rotation. Based on these findings, we can concluded that the rotation regulation has not made any impact to audit quality. Hence, it is necessary to consider other regulation to improve audit quality.

5. CONCLUSION AND DISCUSSION

This paper contributes to ongoing debate about the impact of rotation and tenure to audit quality. This research finds the quadratic relationship between tenure and audit quality (not merely linear relationship as noted in previous research).

This research find that at pre-regulation, audit firm tenure is negatively related to audit quality, the longer the duration of audit assignment, the lower the quality of audit. At post regulation, tenure is convexly related to the audit quality at minimum point 10 years. This implies that audit quality will decrease until first 10 years of the audit engagement, and then will increase. As the time required to improve the audit quality is quite long (approximately 10 years), the relationship between audit firm tenure and audit quality is actually negative. We can conclude that there is a negative relationship between tenure and audit quality at pre-regulation and after regulation period.

At the pre-regulation period, audit firm rotation will decrease the audit quality, but after regulation period, the audit firm rotation doesn't affect the audit quality. This result maybe due to in the pre-regulation period, the rotation requirement is not mandatory. Auditor changes is more due to a disagreement between the client and the auditor so that auditor changes causes a decrease in audit quality. The decrease may be due to new audit firm has not sufficient knowledge about client business and risks. In the post regulation period, the rotation requirement is mandatory but the audit firm rotation do not improve audit quality. So

we can conclude that the benefits of mandatory audit firm rotation were not certain and other requirements were needed.

In the pre-regulation, the relationship between audit partner tenure and audit quality is concave (going up until 3 years and then going down) while in the post-regulation, the relationship between audit partner tenure and audit quality is convex (going down in the first 2 years and then going up). Results from audit partner rotation also support these findings which in the pre and post-regulation period, audit partner rotation positively affects the audit quality. These results indicate that audit partner rotation does improve audit quality. So we can conclude that mandatory audit partner rotation is still needed.

There are several limitations of this study. First, we only use accrual discretion as one of the measurements of earnings quality as a proxy of audit quality. Velury & Jensen (2006) said that there are 4 dimensions of earnings quality such as predictive value (the cash flow-earnings relationship), neutrality (the magnitude of abnormal accruals), timeliness (capacity of accounting earnings to reflect timely the economic income of the firm), and representational faithfulness (the earnings response coefficient). As this proxy examines audit quality from the output of audit, further studies may also examine audit quality from the input and process of audit such as the quality of auditor, the quality of working paper. Second, we put industry specialization as a variable control whereas auditor specialization may impact the relationship between auditor rotation and audit quality. Further studies may include auditor specialization as a moderating variable for the relationship between tenure and audit quality. Third, we have not examined the relationship between tenure and rotation on audit quality for each industry. Further studies may differentiate audit quality in each industry. Fourth, we have not considered corporate governance (such as audit committee) as a variable that may affect the relationship between audit tenure and auditor rotation with audit quality. Future research may include audit committee as a moderating variable for the relationship between tenure and audit quality.

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Appendix

Table 1. Example Changes in Audit Firm Name In Indonesia

	Audit Firm Name	Year	International Affiliation
1	Kanto, Tony, Frans & Darmawan	2004	AGN International
	Kanto Santoso, Tony & Rekan	1998	AGN International

2	Johan, Malonda, Astika & Rekan	2007	Baker Tilly International
	Johan, Malonda & Rekan	1998	Nexia International sampai 2007
3	Tanubrata Sutanto & Rekan	2007	BDO Global Coordination
	Tanubrata Sutanto Sibarani	2006	BDO Global Coordination
	Tanubrata Yogi Sibarani Hananta	2004	BDO Global Coordination
	R.B. Tanubrata & Rekan	1998	BDO Global Coordination
4	Doli, Bambang, Sudarmadji & Dadang	2005	BKR International
	Doli, Bambang & Sudarmadji	2000	Morison International Asia Pasific sampai 2004
5	Osman Bing Satrio & Rekan	2007	Deloitte Touche Tohmatsu
	Osman Ramli Satrio & Rekan	2005	Deloitte Touche Tohmatsu
	Hans Tuanakotta Mustofa & Halim	2003	Deloitte Touche Tohmatsu
	Hans Tuanakotta & Mustofa	1998	Deloitte Touche Tohmatsu
6	Purwantono, Sarwoko & Sandjaja	2006	Ernst & Young Global
	Prasetio, Sarwoko & Sandjaja	2002	Ernst & Young Global
	Prasetio Utomo & Rekan	1998	Arthur Andersen
	Hanadi, Sarwoko & Sandjaja	1998	Ernst & Young Global
7	Hendrawinata Gani & Hidayat	2007	Grant Thornton International
	Hendrawinata Gani & Rekan	2004	Grant Thornton International
	Hendrawinata & Rekan	1998	Grant Thornton International
8	Siddharta Siddaharta & Widjaja	2002	KPMG International
	Siddharta Siddharta & Harsono	1998	KPMG International
9	Eddy Prakarsa Permana & Siddharta	2004	Kreston International
	Eddy Pianto	1998	Kreston International
10	Mulyamin Sensi Suryanto	2006	Moore Stephens International Limited
	Dedy Muliadi & Rekan	2003	Moore Stephens International Limited
	Dedy Muliadi	1998	Moore Stephens International Limited
11	Kanaka Puradiredja, Robert Yogi, Suhartono	2006	Nexia International
	Kanaka Puradiredja & Rekan	2002	DFK International sampai 2007
	Kanaka Puradiredja	2000	DFK International
12	Paul Hadiwinata, Hidayat, Arsono & Rekan	2004	PKF International
	Paul Hadiwinata, Hidayat & Rekan	2000	PKF International
	Paul Hadiwinata, Atmadja & Rekan	1998	PKF International
13	Hertanto, Sidik, Hadisoeryo & Rekan	2007	Polaris IA Internasional
	Hertanto, Djoko, Ika & Sutrisno	2003	Polaris IA Internasional
	Hertanto	1998	IA International
	Djoko Sutardjo	1998	BKR International

14	Haryanto Sahari & Rekan	2004	Price Waterhouse Coopers
	Hadi Sutanto & Rekan	1998	Price Waterhouse Coopers
15	Thomas, Lesmana, Hengky & Rekan	2006	No Affiliation
	Thomas, Trisno, Hendang & Rekan	2002	Baker Tilly International sampai 2006
	Trisno, Thomas Iguna & Rekan	1998	Baker Tilly International
16	Aryanto Amir Jusuf & Mawar	2004	RSM International
	Amir Abadi Jusuf & Aryanto	1999	RSM International
	Amir Abadi Jusuf & Rekan	1998	RSM International

Sources : Wibowo (2009)

Table 2.a. Sample Selection Procedures Model 1 and 2

Year	Pre Regulation			Post Regulation Period					Total
	1999	2000	2001	2004	2005	2006	2007	2008	
Public Listed Company in Indonesia Stock Exchange	307	307	323	330	339	343	343	343	2635
Financial Company (Bank, insurance, leasing, investment)	-51	-56	-55	-63	-69	-70	-76	-76	-516
Non Financial Company	256	251	268	267	270	273	267	267	2119
Data Not Obtained	-153	-148	-165	-164	-167	-170	-164	-164	-1295
Sample	103	103	103	103	103	103	103	103	824
Total	309			515					824

Table 2.b. Sample Selection Procedures Model 3

	Post Regulation (2004-2008) (Firm years)
Public Listed Company In Indonesia	1698
Non Financial Public Listed Company which observed	1.212
Company Did Audit Firm Rotation	445
Company Did Real Audit Firm Rotation	195
Company Did Quasi Audit Firm Rotation	250

Table 3. Statistic Descriptive Model 1 – Pre-Regulation Period (1999-2001)

	Minimum	Maximum	Mean	Std. Deviation	Skewness
CFO t+1	-0.51	5.55	0.20	0.63	5.65
INC	-1.02	1.49	0.03	0.19	0.35
EPS	-5.67	6.19	0.19	1.43	0.42
R	-1.86	4.84	0.48	1.16	1.21
ABSDAC	0.00	1.04	0.11	0.12	3.16
CAR	-2.27	3.88	0.30	1.04	1.12
UE	-8.64	8.27	-0.15	2.34	0.38
PTENURE	1.00	12.00	3.50	2.81	1.26
FTENURE	1.00	21.00	6.20	3.71	0.73
PROTATION	0.00	1.00	0.32	0.47	0.79
FROTATION	0.00	1.00	0.09	0.29	2.80
SPEC	0.00	1.00	0.59	0.49	-0.38
BIG4	0.00	1.00	0.86	0.35	-2.10
LEV	0.03	4.60	0.74	0.57	3.17
GROWTH	-6.51	9.64	1.19	1.80	1.45
SIZE	17.35	24.79	20.35	1.37	0.35
D_LOSS	0.00	1.00	0.28	0.45	1.01
STDEV	0.00	0.37	0.10	0.05	1.68
CFOt	-0.48	3.77	0.15	0.40	6.13
TA (Rp 000 000)	34.31	58275.21	2067.10	5113.19	6.68
Valid N (listwise)			309.00		

Where,

ABS_DAC_{it} : absolut discretionary accruals

FTENURE real audit firm tenure, measured as number of continues years of accounting firm employment
 FTENURESQ real audit firm tenure squared
 FROTATION dummy variable, equal to 1 if there is audit firm rotation and 0 otherwise
 PTENURE audit partner tenure, measured as number of continues years
 PTENURESQ real audit partner tenure squared
 PROTATION dummy variable, equal to 1 if there is audit partner rotation and 0 otherwise
 SPEC dummy variable, equal to 1 if the company is audited by specialized auditor (have > 10% market share in an industry, based on its client's total asset) and 0 otherwise.
 BIG4 dummy variable, equal to 1 if the company is audited by Big4 and 0 otherwise
 LEV debt-to-total asset
 GROWTH price-to-book value
 SIZE natural logarithm of ending book value of total assets

Table 4. Statistic Descriptive Model 2 Post-Regulation Period (2004-2008)

	Minimum	Maximum	Mean	Std. Deviation	Skewness
CFO t+1	-1.63	6.78	0.09	0.36	13.28
INC	-0.63	0.94	0.03	0.11	0.73
EPS	-4.40	4.35	0.05	0.62	-0.34
R	-2.01	4.85	0.25	0.62	1.40
ABSDAC	0.00	0.84	0.06	0.07	4.72
CAR	-2.01	2.63	0.29	0.76	0.75
UE	-6.51	6.50	-0.01	1.72	-0.07
PTENURE	1.00	5.00	1.71	0.80	0.68
FTENURE	1.00	20.00	6.93	5.26	0.57
PROTATION	0.00	1.00	0.50	0.50	0.02
FROTATION	0.00	1.00	0.15	0.36	1.95
SPEC	0.00	1.00	0.50	0.50	-0.01
BIG4	0.00	1.00	0.57	0.49	-0.30
LEV	0.03	4.37	0.60	0.38	3.92
GROWTH	-10.98	21.26	1.47	2.45	3.87
SIZE	11.52	25.24	20.52	1.92	-1.19
D_LOSS	0.00	1.00	0.23	0.42	1.28
STDEV	0.00	0.55	0.08	0.05	3.10
CFOt	-0.41	25.22	0.11	1.11	22.34
TA (Rp 000 000)	0.101	610000	6783.90	39713.60	13.11
Valid N (listwise)			515.00		

Where,

ABS_DAC_{it} absolut discretionary accruals

FTENURE real audit firm tenure, measured as number of continues years of accounting

	firm employment
FTENURESQ	real audit firm tenure squared
FROTATION	dummy variable, equal to 1 if there is audit firm rotation and 0 otherwise
PTENURE	audit partner tenure, measured as number of continues years
PTENURESQ	real audit partner tenure squared
PROTATION	dummy variable, equal to 1 if there is audit partner rotation and 0 otherwise
SPEC	dummy variable, equal to 1 if the company is audited by specialized auditor (have > 10% market share in an industry, based on its client's total asset) and 0 otherwise.
BIG4	dummy variable, equal to 1 if the company is audited by Big4 and 0 otherwise
LEV	debt-to-total asset
GROWTH	price-to-book value
SIZE	natural logarithm of ending book value of total assets

Table 5. Statistic Descriptive Model 3 (2004-2008)

	N	Minimum	Maximum	Mean	Std. Deviation	Skewness
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic
ABSDAC	445	0	0.83	0.07	0.09	4.418
RROTATION	445	0	1	0.438	0.496	0.249

Table 6. Regression Result Model 1 – Audit Firm

Variable	PRE REGULATION				POST REGULATION			
	Column 1				Column 2			
	Coefficient	Prob.	Sig n	VIF	Coefficient	Prob.	Sif n	VIF
C	-0.142	0.020			0.085	0.000		
FTENURE?	0.016	0.000	***	2.8	0.270	0.000	***	13.4
FTENURESQ?	0.000	0.136		2	-0.013	0.000	***	13.3
FROTATION?	0.082	0.000	***	1.7	-0.004	0.150		1.1
SPEC?	0.029	0.000	***	1.2	-0.000	0.436		1.7
BIG4?	-0.048	0.002	***	1.4	-0.001	0.349		1.6
LEV?	0.006	0.091	*	1.2	0.010	0.149		1.2
GROWTH?	0.004	0.012	**	1	0.001	0.021	**	1.1
SIZE?	0.012	0.000	***	1.1	-0.001	0.011	**	1.1
D_LOSS?	-0.015	0.000	***	1.1	-0.002	0.219		1.2
CFO?	0.021	0.000	***	1.1	-0.002	0.000	***	1
Adjusted R-squared	0.756				0.863			
Durbin-Watson stat	3.053				1.542			
Prob(F-statistic)	0.000				0.000			

Dep Var :
ABS_DAC

*: significant at 10 %, ** significant at 5 % ***: significant at 1 %;

Minimum point at post-regulation: $-b/2a = FTENURE/(2*FTENURESQ) = -0.27/(2*0.013) = 10.1$ years

Table 7. Regression Result Model 2 – Audit Partner

Variable	PRE REGULATION Column 1					POST REGULATION Column 2			
	Pred.	Coef	Prob.		VIF	Coeffi cient	Prob.		VIF
C		-0.343	0.001			0.074	0.000		
PTENURE?	+/-	-0.021	0.000	***	7.5	1.269	0.000	***	7.8
PTENURESQ?	+/-	0.003	0.000	***	5	-0.316	0.000	***	7.6
PROTATION?	+/-	-0.037	0.000	***	2.8	-0.001	0.000	***	1
SPEC?	-	0.040	0.000	***	1.2	0.000	0.366		1.6
BIG4?	-	-0.004	0.296		1.2	8,40E	0.463		1.5
LEV?	+/-	0.000	0.989		1.2	-0.002	0.125		1.2
GROWTH?	-	0.003	0.018	**	1	0.000	0.094	*	1.1
SIZE?	+/-	0.020	0.000	***	1.1	0.000	0.034	**	1.1
D LOSS?	-	-0.005	0.080	*	1.1	6,42E	0.461		1.2
CFO?	-	0.011	0.158		1	0.000	0.148		1
Adjusted R-squared		0.686					0.99		
Durbin-Watson stat		2,916					2.67		
Prob(F-statistic)		0.000					0.000		

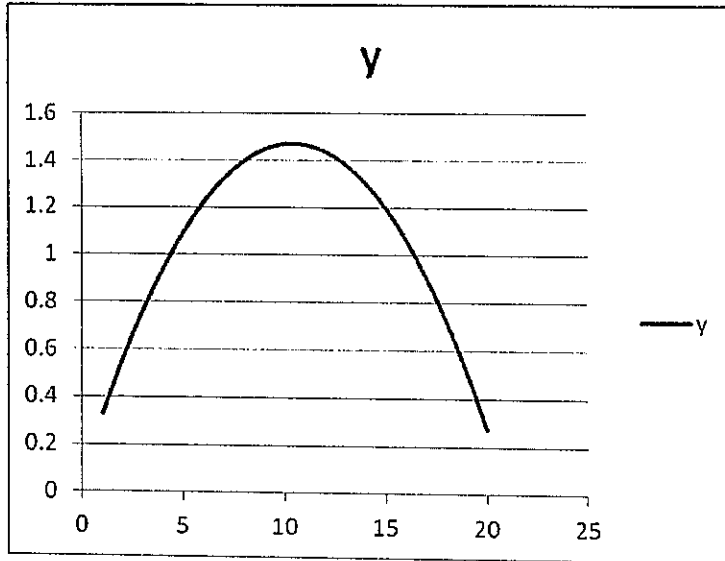
Dep Var: ABS_DAC

Pre Regulation: Maximum point : $-b/2a = PTENURE/2*PTENURESQ = -(-0.021) / (2*0.003) = 3.1$ years (CONCAVE)Post Regulation: Minimum point : $-b/2a = PTENURE/2*PTENURESQ = -(1.269) / (2*0.316) = 2$ years (CONVEX)

Table 8. Regression Result Model 3 – Real & Quasy Rotation

Variable	Coefficient	Prob.
C	0.226	0.006
RROTATION	-0.005	0.688
BIG_4	-0.009	0.471
RISK	0.043	0.059
GROWTH	0.003	0.366
SIZE	-0.009	0.046
D_LOSS	0.013	0.277
CFO	0.00E+00	0.529
Adjusted R-squared	0.09	
Durbin-Watson stat	1.86	
Prob(F-statistic)	0	
n	445	

Figure 1A. The relationship between audit firm tenure and discretionary accrual – post-regulation



X: tenure; Y: accrual discreationer

Figure 1B. The relationship between audit firm tenure and audit quality – post-regulation

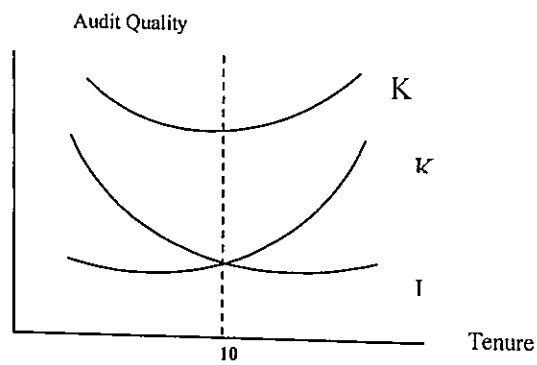


Figure 2A. Relationship between audit partner tenure and discretionary accrual in the pre-regulation

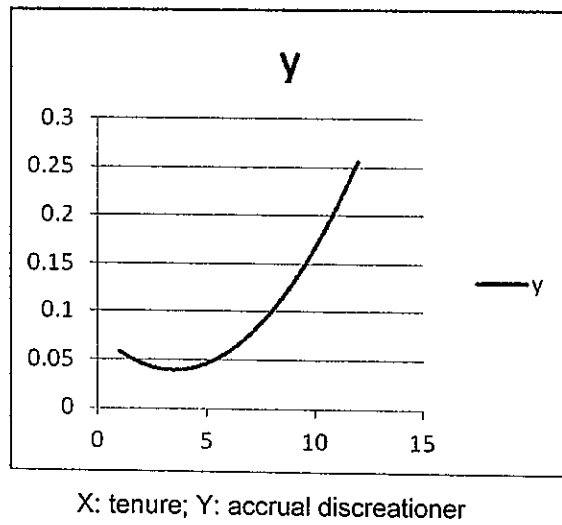


Figure 2B. Relationship between audit partner tenure and discretionary accrual in the pre-regulation

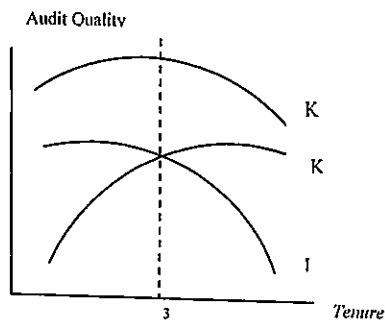


Figure 3A. The relationship between audit partner tenure and discretionary accrual post-regulation

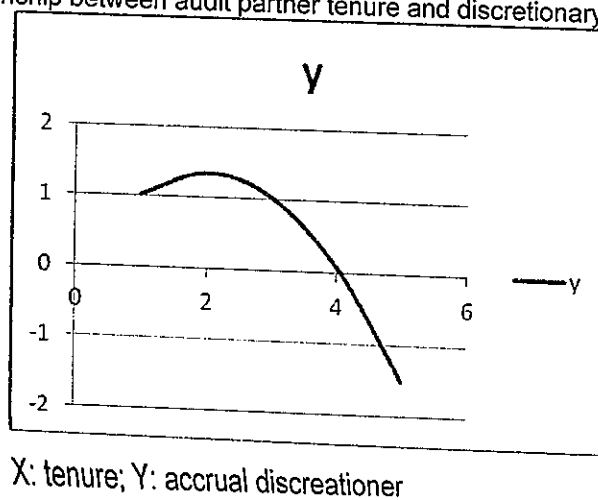
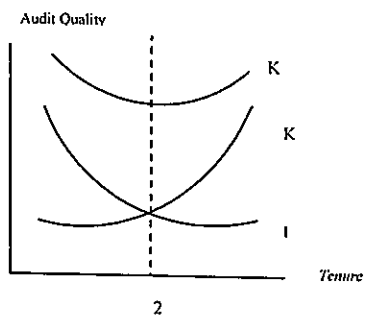


Figure 3B. Relationship between audit partner tenure and audit quality - post-regulation





THE 2ND TJAR CONFERENCE

CONFERENCE PROGRAM DECEMBER 23, 2011

Time	Program
12:00 - 1:00 p.m.	Hall on the 5th Floor REGISTRATION
1:00 - 1:10 p.m.	504 OPENING CEREMONY Hidetoshi YAMAJI, <i>Kobe University, TJAR Editor in chief</i> Nobuaki HAMAGUCHI, <i>Vice-Director of Research Institute for Economics and Business Administration, Kobe University</i>
1:10 - 2:00 p.m.	504 FIRST PLENARY SESSION Moderator Keiichi KUBOTA, <i>Chuo University</i> Speaker Tai-Yuan CHEN, <i>Hong Kong University of Science & Technology</i> Title The Effects of Firm-initiated Clawback Provisions on Earnings Quality and Auditor Behavior Discussant Keiichi KUBOTA, <i>Chuo University</i>
2:00 - 2:15 p.m.	504 COFFEE BREAK
2:15 - 3:45 p.m.	501 CONCURRENT SESSION A Moderator Yasuhiro OHTA, <i>Keio University</i> Speaker Hua LEE, <i>Hong Kong Shue Yan University</i> Title The Value Relevance of Summarized Accounting Information and Audit Quality Discussant Koji OTA, <i>Kansai University</i>
2:15 - 2:45 p.m.	502 CONCURRENT SESSION B Moderator Yoshinao MATSUMOTO, <i>Kansai University</i> Speaker Yoshie SAITO, <i>Eastern Illinois University</i> Title Managerial Decisions to Discontinued Operations and Future Firm Performance Discussant Shota OTOMASA, <i>Kansai University</i>
2:45 - 3:15 p.m.	501 Speaker Sylvia Veronica SIREGAR, <i>University of Indonesia</i> Title Corporate Governance, Financial Reporting Quality, and Investment Efficiency Discussant Masahiro ENOMOTO, <i>Tohoku University</i>
3:15 - 3:45 p.m.	502 Speaker Fitriany Amarullah ABDUL, <i>University of Indonesia</i> Title Do Mandatory Audit Firm And Audit Partner Rotation Really Improve Audit Quality? Discussant Naoki KASAI, <i>Shiga University</i>
3:45 - 4:00 p.m.	501 Speaker Jang Youn CHO, <i>Hankuk University of Foreign Studies</i> Title The Value Relevance of Accounting Information and Types of Investors Discussant Hiromi WAKABAYASHI, <i>Konan University</i>
3:45 - 4:00 p.m.	502 Speaker Hua LEE, <i>Hong Kong Shue Yan University</i> Title Incentive Contracts and Time Pressure on Audit Judgment Performance Discussant Takatoshi HAYASHI, <i>Kwansei Gakuin University</i>
3:45 - 4:00 p.m.	504 COFFEE BREAK
4:00 - 4:50 p.m.	504 SECOND PLENARY SESSION Moderator Yasuhiro OHTA, <i>Keio University</i> Speaker Katsuhiko KOKUBU, <i>Kobe University</i> Title Environmental Management through Material Flow Cost Accounting
5:00 - 6:30 p.m.	Restaurant SAKURA (3rd Floor) AFTER SESSION

TJAR EDITORIAL

ACCOUNTING ENCOUNTERS OF THE TJAR KIND

Accounting theory has taken two distinct approaches: one supports understanding of environment-specific local accounting institutions in various economies, while the other generalizes American and West European accounting institutions across the world. It is easy, albeit costly, to overlook this co-existence of two kinds of theory in the rush to world-wide convergence or integration of accounting. Consideration and comparison of the two may allow us to carefully explore the foundations of the arguments for convergence. However, such exploration requires accounting scholars to observe, examine, evaluate, and critique the proposed systems and alternatives of which convergence itself is a salient element.

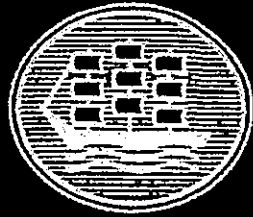
Encounters among cultures since the medieval times have created some commonalities but have not yielded a universal culture. Whether economic encounters among disparate social systems will yield, or even benefit from, a single system of accounting remains open. It is our hope that the Japanese Accounting Review can serve as a forum for accounting scholars across the world to observe, analyze, reflect, and report on encounters between the Western and other system of accounting. The obvious, but far too often neglected, recognition of this duality is a central theme of *TJAR*. The *TJAR* website states:

This new English-language journal, *The Japanese Accounting Review*, aims to present the world with quality research on diverse themes relating to accounting, thereby helping improve the economic welfare of societies around the world through better accounting systems. We welcome submissions, which will be judged solely on the basis of quality of their contributions, not on the status of the hypothesis, methodology, or the author.

Even the so-called capitalist societies differ in their stage of development, and may take very different paths employing quite different institutions. If internationalization is interpreted to assume that all these societies and their paths converge, there is little evidence in support. Accounting scholarship could focus on seeking a critical understanding of the current diversity, and evaluating alternatives for the future, without becoming a prematurely prescriptive cheerleader for convergence. *TJAR* aims to help serve this function.

While the pages of *TJAR* are open to empirical examination of whether the theories originating in the West are robust enough to afford us a better understanding of other economies, they also welcome alternative theories, and their empirical scrutiny, that arise from institutions specific to other economies. The current controversy in Japan about the adoption of IFRS is a good example of a subject for such studies. Development of theories, and analyses of data relevant to cross-economy encounters are important goals of *TJAR*.

HIDETOSHI YAMAJI
The Japanese Accounting Review, Editor in chief



THE JAPANESE ACCOUNTING REVIEW

Research Institute for Economics and Business Administration, Kobe University

Certificate

Presented to

DR. FITRIANY AMARULLAH ABDUL MUTHALIB

for presenting the Concurrent Session B:

Do Mandatory Audit Firm And Audit Partner Rotation Really Improve Audit Quality?

at the 2nd TJAR Conference

Kobe University

December 23, 2011

Hideyoshi Yamaji

THE JAPANESE ACCOUNTING REVIEW, Editor in Chief
The 2nd TJAR Conference, Chairperson

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