CHAPTER I

INTRODUCTION

1.1 Research Background

The globalization and digitalization of the modern business environment have introduced unprecedented complexities that challenge traditional auditing approaches. Cross-border transactions, rapid technological advancements, and growing demands for transparency and regulation have heightened the need for high audit quality (Vuković et al., 2023). Reliable financial reporting not only supports sound internal decision-making but also shapes the perceptions of investors, regulators, and the broader community regarding a company's integrity. As such, audit quality has become a cornerstone in ensuring public trust in financial statements and maintaining the credibility of financial markets. (IFAC, 2020).

In Indonesia, the need for high audit quality is particularly critical due to the dynamic growth of its business sector and the increasing prevalence of financial irregularities and high-profile audit failures. Notable cases, such as those involving Garuda Indonesia and Jiwasraya, have highlighted significant shortcomings in audit practices, leading to severe economic losses and diminished public trust. The Jiwasraya insurance scandal, for instance, resulted in losses amounting to trillions of rupiah, raising questions about the integrity of financial reporting and the role of auditors in detecting and preventing fraud (Naranasrullah, 2020). Similarly, the Garuda Indonesia case exposed how financial misstatements can persist undetected, despite the involvement of auditors, revealing weaknesses in audit quality

(Mardika, 2020). These cases underscore the urgent need for stronger mechanisms to ensure audit quality, especially within Public Accounting Firms (KAPs).

The public accounting firm in Indonesia is dominated by several major firms, including Deloitte, Ernst & Young Indonesia, PricewaterhouseCoopers (PwC) Indonesia, Klynveld Peat Marwick Goerdeler (KPMG) Indonesia, Binder Dijker Otte (BDO) Indonesia, RSM Indonesia, Grant Thornton LLP, Crowe Indonesia, Mazars Indonesia, and KAP Anwar & Rekan. (Ramadhana, 2023). These firms, particularly those affiliated with international networks, play a crucial role in maintaining audit quality standards and facilitating cross-border transactions. However, to the knowledge of the offers, we have not found any representative office of this accounting firm operating in Medan, but it does not mean that they don't have clients in the Medan region.

Nevertheless, Medan is home to *KAP Johan Malonda Mustika and Partner*, a public accounting firm that is affiliated with *Baker Tilly International*, one of the world's top 10 professional services networks. Baker Tilly operates across tax, advisory, assurance, legal, and other professional services, with a vast network of experts serving clients across five continents. This affiliation provides businesses in Medan with access to international expertise and global best practices in accounting and advisory services. (Bakertilly International, 2025). Additionally, there are also several local Public Accounting Firns (KAP) in Medan that are affiliated with foreign parties, even though they are not included in the Big 5. These include KAP Hendrawinata Eddy Sudharta and Tanzil, which is affiliated with Kreston Global, as well as KAP Paul Hadiwinata, Hidajat, Arsono & Rekan, which is affiliated with PKF International. There is also KAP Joachim Adhi Piter Poltak & Partners, which is a member of The Leading Edge Alliance (LEA), and KAP Dr. Wagimin Sendjaja, Ak, CA, CPA which is a partner of KAP PKF Hadiwinata and is therefore indirectly affiliated with PKF International. Furthermore, KAP Kanaka Puradiredja Suhartono has also established an affiliation with Nexia International.

The rapid advancement of digital technology has significantly impacted auditing processes, including in Medan. With the increasing reliance on digital financial systems, cloud computing, and artificial intelligence, auditors must adapt to new challenges in verifying financial data and ensuring cybersecurity. Public Accounting Firms in Medan, particularly smaller KAPs, may face difficulties in integrating advanced IT-based audit tools due to resource constraints. The use of data analytics, blockchain technology, and automated audit procedures is becoming essential for detecting anomalies and enhancing audit efficiency. However, many auditors in Medan may not have sufficient training in these emerging technologies, which could hinder audit quality and increase the risk of undetected financial fraud. Moreover, with the absence of international audit firms in Medan, access to cutting-edge IT-driven audit methodologies remains limited, making it imperative for local firms to invest in digital transformation initiatives.

Achieving consistent audit quality in Indonesia faces multiple challenges that arise from both internal factors, such as auditor competence and independence, and external factors, including regulatory complexities and technological disruptions. Indonesia has witnessed an alarming rise in financial fraud and misstatements among major corporations, often linked to poor audit quality

(Mayangsari, 2020). Cases like Jiwasraya, Asabri, and the Century Bank scandal illustrate how ineffective audits can allow fraud to go undetected for years. These cases not only erode public confidence but also highlight deficiencies in auditors' ability to assess risks and detect anomalies in financial reporting (Panuntun & Irfan Adristi, 2021). Additionally, the globalization of business operations has introduced cross-border transactions and sophisticated financial instruments that require advanced audit procedures.

However, many auditors in Indonesia lack the necessary expertise to address these complexities effectively (Dhanny & Yuliati, 2021). Furthermore, Indonesia's regulatory environment is continuously evolving, with the introduction of international standards, such as IFRS, and local standards, such as SAK (Asean briefing, n.d.). Keeping pace with these changes while maintaining compliance is a persistent challenge for Public Accounting Firms (Sinaga, n.d.). The role of IT in enhancing audit quality is becoming increasingly evident, as automated tools can help mitigate human errors, improve risk assessments, and ensure compliance with evolving regulations. For auditors in Medan, upskilling in IT-based audit tools is crucial to maintaining competitiveness and meeting industry standards.

Digitalization has further transformed financial reporting processes, introducing new risks such as cybersecurity threats, manipulation of digital records, and the use of emerging technologies like blockchain (Deloitte, 2021). Auditors are often unprepared to address these risks, as traditional audit approaches may not be sufficient to evaluate the integrity of technologically advanced financial systems (KPMG, 2021). Moreover, the lack of training in auditing digital assets and complex IT systems exacerbates this challenge. Public confidence in the auditing profession has also been shaken due to recurring audit failures and ethical breaches. High-profile scandals have raised concerns about auditors' independence and professional integrity (Curtis et al., 2022).

Cases of auditors colluding with clients to conceal financial misstatements, as seen in the Garuda Indonesia case, highlight the ethical dilemmas that auditors face and the systemic weaknesses in monitoring and enforcement (Binus, 2021). Maintaining auditor independence is a persistent issue, particularly in long-term engagements with clients. Prolonged audit tenure can lead to familiarity bias, reducing objectivity and compromising audit quality. While Indonesia's Regulation of the Minister of Finance 186/PMK.01/2021 imposes limits on audit tenure to safeguard independence, its effectiveness remains debated (Keuangan, 2021). On the other hand, shorter tenures may limit an auditor's ability to develop a deep understanding of the client's business, creating challenges in identifying risks and misstatements (Faisal et al., 2019).

Another critical issue is the gap in auditor competencies, particularly in addressing modern risks associated with digitalization and globalized business practices. Many auditors lack the necessary training and expertise to effectively audit complex financial instruments or assess risks such as cybersecurity threats, which are becoming increasingly prevalent in financial reporting. These deficiencies are particularly pronounced in smaller Public Accounting Firms, where resources for professional development may be limited. Addressing these gaps requires greater investment in IT training programs, particularly in regions like Medan, where exposure to international audit methodologies is less direct.

Understanding these factors in the Indonesian context is essential for improving audit practices and restoring public trust. This study aims to address these gaps by investigating the influence of auditor work experience and competence on audit quality, with audit tenure as a moderating variable. Focusingon auditors in Public Accounting Firms (KAPs) in Medan, the study seeks to provide insights for regulators on optimizing audit tenure policies and assist KAPs in developing human resource strategies to enhance audit quality. By addressing the challenges outlined above, this research contributes to the academic literature and offers practical solutions for strengthening the auditing profession in Indonesia.

In the context of Medan, recent studies have highlighted specific challenges and factors influencing audit quality. Research examining professionalism, objectivity, independence, and auditor competence in Medan's Public Accounting Firms has revealed varying impacts on audit quality. While some studies found that professionalism and independence had no significant effect on audit quality, auditor competence consistently emerged as a crucial factor positively influencing audit outcomes (Lubis & Salisma, 2023). Furthermore, research involving 50 auditors from 15 KAPs in Medan demonstrated that auditor experience significantly affects audit quality, emphasizing the importance of practical expertise in maintaining high audit standards. (Arnita et al., 2023). In addition, a study published about 9 months ago examined the effect of accountability, auditor experience, and objectivity on audit quality at KAP in Medan City. This study uses primary data obtained through questionnaires given to auditors who work at KAP in Medan. The results showed that accountability, auditor experience, and objectivity have a significant effect on audit quality. (Akuntabilitas et al., 2024).

Audit quality is essential for instilling confidence in financial statements, enhancing transparency, and supporting financial market stability. According to (Arens et al., 2020), auditing involves systematically collecting and evaluating evidence to ensure compliance with established criteria, such as Generally Accepted Accounting Principles (GAAP) or Financial Accounting Standards (SAK). Reliable audits provide assurance to stakeholders, such as investors, creditors, and regulators, that financial statements accurately reflect an entity's financial position and performance.

Furthermore, the International Auditing and Assurance Standards Board (IAASB, 2018) emphasizes that audit quality extends beyond detecting misstatements to include risk assessment and evaluation of internal controls. In Indonesia, the Public Accountant Professional Standards (IAPI, 2021) provide a regulatory framework for ensuring audit quality and independence. However, the challenges of modern business practices necessitate a deeper understanding of how factors like work experience, competence, and audit tenure interact to influence audit outcomes.

Despite extensive studies on factors influencing audit quality, significant gaps remain in understanding the interplay between auditor work experience, competence, and audit tenure. Several research focuses on the direct effects of work experience and competence on audit quality, often neglecting the moderating role of audit tenure. Globally, research has explored the impact of audit tenure on independence, but limited studies address its role in Indonesia's unique regulatory and business environment. Moreover, there is little empirical evidence specific to Public Accounting Firms (KAPs) in Medan, a region characterized by distinct economic and regulatory dynamics. Understanding these factors in the Indonesian context is essential for improving audit practices and restoring public trust.

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1.2 Problem Identification

Based on the background that has been described, here are some identification of problems in the research, namely:

1. Differences in auditor work experience affect audit quality, where auditors with minimal experience tend to have difficulty handling complex audit situations or detecting fraud in financial statements.
2. Auditors who do not comply with the Public Accountant Professional Standards (SPAP) contribute to audit quality irregularities, thereby reducing stakeholder

confidence in financial statements.

3. The role of auditor competence in ensuring the detection of anomalies and adherence to professional standards in the audit process.
4. The impact of audit tenure on audit quality, particularly as a moderating variable that can strengthen or weaken the relationship between work experience, competence, and audit outcomes.
5. Regulations regarding audit tenure are not yet optimal, where restrictions on the auditor's tenure in accordance with the Minister of Finance Regulation 186/PMK.01/2021 have not fully answered the challenge of maintaining a balance between independence and understanding the client's business.
6. There is a lack of research that addresses how audit tenure interacts with auditor experience and competence in Public Accounting Firms (KAP) in Medan

1.3 Research Limitations

This study focuses on investigating the influence of auditor work experience and competence on audit quality, with audit tenure as a moderating variable. The scope of the study is limited to auditors working in Public Accounting Firms (KAP) in Medan, Indonesia, to provide local insight into audit practices in this region. Although this study aims to explore the relationship between the selected variables, it does not comprehensively address all factors that may affect audit quality, such as organizational culture, audit fees, or external environmental factors such as regulatory pressure or economic conditions. Furthermore, this study is limited to examining work experience and competence as the main independent variables, excluding other personal or professional characteristics of auditors, such as ethical behavior, emotional intelligence, or decision-making skills, which may also affect audit outcomes. These limitations are intended to maintain the focus and manageability of the study, ensuring an in-depth exploration of the specific variables being investigated.

In this study, an error was identified in the questionnaire item related to the audit tenure variable. The researcher still referred to the previous regulation issued by the Ministry of Finance, which stated that a Public Accounting Firm (KAP) could provide audit services to the same client for six consecutive years. However, this provision has been revised to a maximum of five years under the current regulation. Consequently, the reference used in this study is no longer relevant to the present context, which may have contributed to the insignificant relationship found between work experience and competence on audit quality when moderated by audit tenure.

1.4 Research Problems

Based on the above background, in this study, the problem formulation are:

1. How does auditor work experience influence audit quality in Public Accounting Firms (KAP) in Medan?
2. How does auditor competence influence audit quality in Public Accounting Firms (KAP) in Medan?
3. How far does audit tenure moderate the relationship between auditor work experience and audit quality at public accounting firms (KAP) in Medan?
4. How far does audit tenure moderate the relationship between auditor competence and audit quality at the Public Accounting Firm (KAP) in Medan?

1.5 Research Objectives

The research objectives of the research conducted are:

1. To determine the influence of auditor work experience on audit quality at the Public Accounting Firm (KAP) in Medan, Indonesia.
2. To determine the influence of auditor competence on audit quality at the Public Accounting Firm (KAP) in Medan, Indonesia.
3. To determine the moderating influence of audit tenure on the relationship between auditor work experience and audit quality at public accounting firms (KAP) in Medan, Indonesia.
4. To determine the moderating influence of audit tenure on the relationship between auditor competence and audit quality at the Public Accounting Firm (KAP) in Medan, Indonesia.

1.6 Research Benefits

1. For Researchers

   This research contributes to the academic understanding of how work experience and auditor competence affect audit quality, particularly in the context of public accounting firms (KAP) in Indonesia. This research provides a foundation for future research by highlighting the moderating role of audit tenure and uncovering potential areas for further exploration, such as ethical considerations or organizational culture in auditing. The research process also enhanced the researcher's skills in quantitative data analysis, critical thinking, and problem-solving related to audit practice.

2. For Institutions

   This research provides input for regulatory bodies, such as the Ministry of Finance and IAPI (Indonesian Institute of Public Accountants), to refine policies related to audit tenure and improve guidelines on auditor competence and work experience requirements. Public accounting firms (KAPs) can use these findings to improve their audit processes, implement better training programs, and enhance human resource strategies to ensure high-quality audits. By understanding the factors that affect audit quality, institutions can work to restore public confidence in the audit profession, especially after high-profile audit failures.

3. For Auditors

   This study highlights the importance of work experience and competence, encouraging auditors to pursue continuous professional development and certification to improve their audit performance. By examining the moderating role of audit tenure, auditors gain a better understanding of how their relationship with clients can impact audit independence and quality, helping them to maintain professional integrity. The findings provide practical insights into how auditors can overcome challenges in a complex business environment, such as adapting to globalization, technological change, and stricter regulatory demands.