Impact of Auditor Reputation on Sukuk Rating

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Keywords: Auditor reputation, sukuk rating, auditor.

Abstract: This study aims to analyse the growth of Islamic banking and finance has obtained momentum over the last decade, especially in the field of sukuk and securitization, whether among sukuk business entities gaining popularity as an alternative source of funding. One of the factors that support the development of sukuk is the rating. An investor who will invest in sukuk will definitely pay attention to the rating of the sukuk. Sukuk rating is very helpful to investors who want to invest in bonds, so investors will know the return earned with the risk borned. This research aimed to examine the influence of auditor reputation on sukuk rating in Indonesia. The population of this research was all companies issuing sukuk from 2013-September 2016. The sampling method used in this research was purposive sampling. There were 8 companies as samples. Analysis technique used in this research was an ordinal logistic regression. The result of this research showed that auditor reputation did not have a significant effect on sukuk rating.

1 INTRODUCTION

The growth of Islamic banking and finance has gained momentum in the last decade, particularly in sukuk and securitization, in that sukuk has increasingly earned its popularity as an alternative source of funding for both entrepreneurs and enterprises (Ayub, 2007:389). At international and national level, this instrument has swiftly flourished along with the growth and development of other more conventional financial instruments (Datuk, 2014). The sukuk market indicated strong growth from USD 45 billion in 2011 to nearly threefold at USD 118.8 billion in the first trimester of 2014. This development was spurred by primary sharia stock markets, namely Malaysia, Saudi Arabia and the United Arab Emirates, and new ones such as Turkey and Indonesia. Indonesia attained 4th place (14.1%) after Malaysia (42.3%), United Arab Emirates (18.2%) and Bahrain (14.2%), a highly gratifying development for the sharia financial market in Indonesia. Sukuk first emerged in Indonesia in early September 2002 with the issuance of the sharia bonds of PT Indosat Tbk, the first sharia bonds with a mudharabah contract (Arisanti et al., 2013). A factor that propels the development of sukuk is its rating (Sudaryanti et al., 2011). A sukuk rating significantly helps investors who intend to invest in a bond, so that they can determine the returns they receive and the risks they take (Purwaningsih, 2013). A credit rating is a formal opinion given by a rating agency on the loan default risk faced when investing in a particular bond (Fabozzi and Drake, 2009:697). However, it must be understood that this rating is only intended to measure the default risk level of a debt security emission, not the external (market) risk (Hadi, 2013:108). The credit rating mainly functions as information distributed in the stock market (Arundina, 2009), and to support public policies in limiting speculative investments by institutional investors such as banks, insurance companies and pension funds (Arisanti et al., 2013). Satriani (2012) noted that from 2012, every enterprise listed in the stock market or emitter issuing sukuk is required to obtain a credit rating from a credit rating agency, as sanctioned by the Bapepam-LK Rule Number IX.C.11 concerning the Rating of Debt Securities and Sukuk and the Financial Services Authority Regulation Number 18/POJK.04/2015 regarding the Issuance and Requirements of Sukuk.

The Financial Services Authority (OJK) in its Regulation Number 59/POJK.04/2015 pertaining to Publication by a Credit Rating Agency defines a credit rating agency as an investment adviser in the form of a limited liability company which conducts rating and rating assignment activities. Prasetyo (2015) mentioned that Indonesia has six rating agencies approved by Bank Indonesia (BI) and OJK,

Fitriyah, F., Wildan, W. and Handoyo, S.
Impact of Auditor Reputation on Sukuk Rating.
In *Proceedings of the 1st International Conference on Islamic Economics, Business, and Philanthropy (ICIEBP 2017) - Transforming Islamic Economy and Societies*, pages 359-363
ISBN: 978-989-758-315-5

namely Fitch Ratings, Moody's Investor Service, Standard and Poor's, PT Fitch Ratings Indonesia, PT Pemeringkat Efek Indonesia (PEFINDO), and PT ICRA Indonesia (Investment Information and Credit Rating Agency of India). The credit rating scale, symbols and definitions vary between the rating agencies. A credit rating is commonly expressed on an alphabetical or numerical scale and the symbols are defined differently by each agency. The credit rating scale typically ranges from AAA as the top rating to D as the lowest, indicating default (U.S Securities and Exchange Committee, 2013). In theory, a credit rating is used to assess a debt obligation, but in practice it is often assumed as an attribute of the issuer (Hull, 2012:18).

A higher rating implies that the emitter does not have any problem in fulfilling its payment obligation (Cecchetti and Schoenholtz, 2015:163). The quality of a bond can be monitored from its rating information (Arisanti et al., 2013). Once a rating is assigned to the issued bond, the credit rating agency will monitor the quality of the issuer's credit and may alter the given rating (Fabozzi, 2013:19-20). An example of rating change, as cited from the online news site okezone.com dated 20 April 2016, occurred to the bonds rating of a company with the emitter code ADHI for Revolving Sukuk Mudharabah Tranche I Year 2012 and Tranche II Year 2013 from A to A-, and, as reported by the online news site beritasatu.com on 29 February 2012, PT PEFINDO degraded the rating of Sukuk Ijarah II/2009 of PT Berlian Laju Tanker Tbk (BLTA) to idD(sy) from idCCC(sy). Another factor that may affect a sukuk rating is the auditor's reputation. Widowati et al. (2013) concluded that a debt security issued by a company audited by a Big-Four public accounting firm possesses a higher chance of obtaining an investment-grade bonds rating than from a company not audited by one of the Big Four. PT Pemeringkat Efek Indonesia or better known as PEFINDO is the oldest rating agency in Indonesia. Until now PEFINDO has assigned ratings to over 500 enterprises and local governments. Stock market instruments such as bonds, sukuk, and medium-term notes have also been rated by PEFINDO, which is the rating agency market leader in Indonesia (Melis, 2015).

2 LITERATURE REVIEW

2.1 Public Accountant Firm

According to Law Number 5 Year 2011 on Public Accountants, Public Accounting Firm (KAP) is a business entity established under the provisions of legislation and obtaining a business license under the Act. The public accounting firm is managed as a sole proprietorship service, general or limited partnership, or company. Public accounting firms usually offer a variety of professional services in addition to financial statement audits.

2.2 Reputation Auditor

The reputation of an audit firm is not determined primarily by the quality of its audit work, but rather how the firm is viewed more generally, i.e. by its reputation in the financial community. Reputation has been defined as follows: Reputation is the estimation of the consistency over time of an attribute of an entity. This estimation is based upon the entity's willingness and ability to repeatedly perform an activity in a similar fashion. Reputation is an aggregate composite of all previous transactions over the life of the entity, a historical notion, and requires consistency of an entity's actions over a prolonged time for its formation. (Herbig et al., 1994, p. 23).

Reputation is a multidimensional construct and so an accounting firm will have a composite reputation reflecting its reputation for quality work in the numerous services that it offers, e.g. auditing, accountancy, taxation, management consultancy, computer systems advice, personnel selection etc.

Its reputation for quality work in one area is quite likely to affect its reputation in another, as shown by Jacoby and Mazursky (1984), who investigated the effects of selling products with either favourable or unfavourable images in stores, which themselves had either a favourable or an unfavourable image. They found that a retailer with a relatively low image could improve this image by associating it with a more favourable product image. Similarly, a very favourable retailer image was likely to be damaged if it became connected with brands having less positive images. Consequently, it is reasonable to suppose that the various reputations for each of the services offered by an accounting firm will tend to influence each other. In addition, an audit firm is likely to benefit if it has prestigious clients with good reputations, as has been observed for Price Waterhouse in the 1980s (Stevens, 1981).

2.3 Sukuk

Sukuk is a new term introduced to replace the term Islamic bonds. Sukuk is the plural form of the word "sakk" in Arabic, which means a certificate or proof of ownership (Hidayat, 2011:112). The Indonesian Ulama Council through the fatwa of the National Sharia Board number 32/DSN-MUI/IX/2002 defines a sharia bond (sukuk) as a long-term security based on sharia principles issued by an emitter to a sharia bondholder who obliges the emitter to pay revenues to the sharia bondholder in the form of dividends/margins/fees and to repay the original amount at maturity. The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI, 2008) by Shari'ah Standard No. (17) on Investment Sukuk defines sukuk as "certificates of equal value representing undivided shares in ownership of tangible assets, usufruct and services or (in the ownership of) the assets of particular projects." OJK in the Financial Services Authority Regulation Number 18/POJK.04/2015 concerning Issuance and Requirements of Sukuk defines sukuk as credits in the form of certificates or proofs of ownership issued in accordance to sharia principles with equal value and representing undivided shares of the underlying assets.

Table 1: Sukuk rating.

Sukuk Rating	Frequency	Percentage (%)
idA-	14	16.3
idA	15	17.4
idA+	19	22.1
idAA-	22	25.6
idAA	7	8.1
idAA+	3	3.5
idAAA	6	7.0

3 METHODS

Research by Widowati et al. (2013) revealed that auditor reputation influences sukuk rating, but this result contradicts findings of a study by Kusbandiyah and Wahyuni (2014). The argument underpinning the inclusion of auditor reputation is that an auditor with a better reputation would be able to detect material errors in financial reports and report such findings. The higher expertise of the Big-4 firms not only stems from their superior resources but also from their trained experts, better knowledge, and investment in information technology, as compared to accounting firms outside the Big 4 (DeAngelo, 1981). Higher auditor reputation results in reliable audit outcomes, thus reducing the possibility of company failure. Big-4 firms warrant better auditing quality than non-Big-4 ones, hence audits by the Big 4 are expected to produce higher ratings than audits by non-Big 4 firms. Big-4 accounting firms have international procedural standards presumed to yield independent opinions, decreasing agency risk and lowering default risk which eventually raise the sukuk rating (Melis, 2015). Based on those studies, the hypothesis formed is: Auditor reputation influences sukuk rating.

The method utilized in this study was an explanatory survey with secondary data from trimester financial report publications by sukuk-issuing companies per PT PEFINDO ratings. The research object was the reputation of auditors of companies that issued sukuk and the financial statements. The subjects of this study were company sukuk ratings released by PT PEFINDO between 2013 and 30 September 2016.

4 RESULTS

Table 1 shows that the most frequent rating given by PT PEFINDO to the sample companies was idAA- at 25.6% and the least was idAA+ at 3.5%. The highest rating of idAAA at 7.0% was granted to PT Indosat Tbk from period III (July-September) year 2014 until period III year 2016, while the lowest in this study, idA- at 16.3%, was assigned to just 2 companies, namely PT Tiga Pilar Sejahtera Food between period II (April-June) year 2013 and period I (January-March) year 2016 and PT Adhi Karya in period II and III year 2016.

This points out that overall the sukuk issued by the sample companies had reasonably high ratings of idAAA, idAA and idA which can be classified as superior to strong, denoting that PT PEFINDO deemed the sample companies to have the capacity to fulfil their commitment over their sharia financial contracts.

Table 2: Auditor reputation frequency distribution.

Auditor reputation	Frequency	Percentage (%)
Not affiliated with the Big 4	49	57
Affiliated with the Big 4	37	43

Table 2 displays the frequency distribution of the auditor reputation variable. The proportion of companies audited by firms unaffiliated with the Big 4 was 57%, quite similar to that of companies audited by firms affiliated with the Big 4 at 43%.

Those data suggest that auditor reputation was not a term of preference for companies in selecting their external auditor. There were other factors that companies took into account, including expertise in particular industries, applied service fees, and past experiences with public accounting firms.

Data analysis produced a significance value of 0.065, greater than the alpha value 0.05 (>0.05), indicating that auditor reputation does not affect sukuk rating. This result is consistent with that of research by Melis (2015) and Kusbandiyah and Wahyuni (2014) which stated that auditor reputation does not influence sukuk rating. However, this study contrasts that of Widowati et al. (2013) which found evidence of auditor reputation's impact on sukuk rating. The outcome also disproves the initial hypothesis that companies audited by highly reputable public accounting firms (the Big 4 or affiliated with them) would have low default risk, as many accounting firms with high repute have been involved in financial scandals, such as in the case of Enron which colluded with Arthur Andersen, KPMG Siddharta and Harsono which bribed tax officers to lower taxes imposed on PT Eastman Christensen, the Prasetio, Sarwoko and Sandjaja accounting firm which manipulated financial reports by making two different reports for Bank Lippo, and the Haryanto, Sahari and Rekan (PwC) accounting firm which did not disclose material affiliation with PT Indofarma.

Meanwhile, the general purpose of financial reporting by an independent auditor is to express opinion regarding reasonability in all material aspects, financial position, operational results and cashflow in line with applied accounting principles (Hery, 2011:30). Nevertheless, this objective does not necessarily make financial reports free from deviance, which may emerge from audit outcomes. Such possibility largely depends on current materiality since materiality levels generate diverse opinions. Materiality level determination greatly relies on the auditor's subjectivity in assessing risk, whereas the subjectivity itself is influenced by independence. According to Fahmi (2013:174-175), the problem of low auditor independence occurs when the auditor is assigned to audit a company whose top management includes someone who has contributed to the development of the accounting firm or a former senior auditor of a public accounting firm with a high standing among other auditors. Another condition that may lead to auditor partiality is when the auditor has received payment as compensation for a settlement.

As a rating agency does not consider auditor reputation in analyzing a company's credit, the reputation of the accounting firm auditing the company does not guarantee that the firm will employ an auditor with integrity who is capable of performing a good quality audit and protecting the interest of investors and other stakeholders.

5 CONCLUSIONS

A sukuk rating is an important piece of information for investors who intend to invest their capital in the stock market, particularly sukuk as an investment instrument. This study analyzed a factor that may affect sukuk rating, namely auditor reputation. The research involved 8 (eight) sample companies in 2013-2016, resulting in 86 units of analysis. Data analysis and discussion of its results led to the conclusion that auditor reputation does not impact sukuk rating, evidenced by a greater significance value than the alpha (0.065> 0.05). Therefore, whether an emitter is assessed by an auditor affiliated with the Big 4 or not does not exert any influence on the obtained sukuk rating.

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