

The Effect of Financial Distress, Company Growth Rate and Company Complexity on Auditor Switching in Manufacturing Companies

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ABSTRACT: This study aims to obtain empirical evidence of the effect of financial distress, company growth rate, and company complexity on auditor switching in manufacturing companies of Indonesia Stock Exchange which were listed in 2015 - 2019. The study was conducted by analyzing annual financial reports published on the IDX website. The sampling method used was purposive sampling method. The sample in this study were 25 manufacturing companies. The data analysis technique used logistic regression. The results showed that financial distress had a positive and significant effect on auditor switching, the company growth had a negative and significant effect on auditor switching, and company complexity had a negative and significant effect on auditor switching.

KEYWORDS: *auditor switching, financial distress, company growth rate, company complexity*

I. INTRODUCTION

Auditors or what are referred to as third parties are known for their strong independent attitude to assess the fairness of the results of the company's financial statements which are a guarantee for the company to publish its financial statements (Kencana, 2018). In accordance with Audit Standard 240, it is stated that auditors who perform audits in accordance with Audit Standard are responsible for obtaining reasonable assurance whether the financial statements as a whole are free from material misstatement, caused by fraud or error. In working, auditors are encouraged not to have a deeper relationship with the client company so that the independence of an auditor is not in doubt.

Mohamed and Habib (2013) stated that mandatory auditor switching is the right solution that is being proposed and implemented in various countries to overcome the problem of lack of auditor independence. Limitation of tenure (audit engagement period) is an attempt to prevent the auditor from interacting too closely with the client so as not to interfere with the independence of the auditor. Auditor switching occurs at least once in five years, and this will be considered normal because it is mandatory. Fitriani and Zulaikha (2014) state that a sudden auditor switching will raise suspicion from users of accounting information, and it will make information users question what underlies the company doing auditor switching.

Based on data from the Ministry of Finance as of December 31, 2018, several SOEs in various industrial fields recorded low scores on the Altman Z Score index. This index measured of control over the financial status of a company that is experiencing financial difficulties. A number show a company is in the red zone or financial distress is below 1.23 for manufacturing companies. The phenomenon of the decline in the business of manufacturing companies can make companies switch auditors to get a fair assessment of financial statements. Auditor switching has implications for the credibility of financial reporting and the costs of monitoring management activity (Huson et al. 2000). Companies that switch auditors must be prepared to bear more costs when engaging with the new auditor. Not only companies who feel the impact, but the old auditors are also affected. The auditor will lose clients and income because the engagement period has ended (Nazri et al., 2012).

Companies will seriously consider the issue of switching auditors because the auditors that they have been used already know and understand the condition of the company. If the company switch auditors, the company worries that the new auditors will conduct an examination of the bookkeeping system and underestimate their company's bookkeeping quality standards. This can result in delays in the presentation of financial statements that make the company bear the costs of late fees. Then, there is a conflict of interest with the auditors in carrying out audit tasks and providing consulting services. This conflict of interest may interfere

with the independence of the auditor which will affect the audit opinion. Companies in Indonesia feel that this can provide benefits, so companies are reluctant to switch auditors.

Uncertainty in the business of companies experiencing financial distress and even being threatened with bankruptcy creates conditions that encourage companies to switch auditors (Astrini and Muid, 2013). Based on the theory of reasoned action (TRA), it assumes that behavior changes based on the results of behavioral intentions, and behavioral intentions are influenced by social norms and individual attitudes towards behavior, so the company tends to make the decision to do auditor switching because the company has the intention to get a fair opinion from the auditor. When a company experiences financial distress, the company gets social pressure from stakeholders. Then, in order for company to continue to get financial support from its stakeholders, the company tends to do auditor switching to get a fair opinion.

Research conducted by Kusuma and Farida (2019) found that financial distress affects the company's decision to do auditor switching. Francis & Wilson (1988) said that companies experiencing financial distress tend to switch their auditors to increase shareholder confidence. Auditor switching can be a consequence of deliberate behavior by the company to avoid a negative image that is detrimental to users of financial information, accounting for financial audit reports and shareholders (Heliodoro et al., 2016). However, the results of research conducted by Utami (2015), Mahindrayogi and Suputra (2016), and Susanto (2018) found that financial distress has no effect on the company's decision to do auditor switching.

The growth variable of client companies also has contradictory research results on auditor switching. Huson et al. (2000), Nazri et al. (2012) and Soraya and Haridhi (2017) found that the growth of client companies has a positive effect on auditor switching. Meanwhile, research conducted by Khasanah and Nahumury (2013) and Adha and Noch (2017) found that the growth rate of client companies has a negative effect on auditor switching. The complexity of the audit can be attributed to the presence of a "loss of control" (Abdel-Khalik et al. 1983). The more complex a company is, the higher the "loss of control" that will occur.

II. LITERATURE REVIEW AND RESEARCH HYPOTHESIS

Theory of Reasoned Action (TRA) and Theory of Planned Behavior (TPB) are used as literature in this study. Theory of Reasoned Action (TRA) describes behavior that changes based on the results of behavioral intentions, and behavioral intentions are influenced by social norms and individual attitudes towards behavior. The basic assumption based on this theory is that humans behave in a conscious way and consider all available information. The Theory of Planned Behavior (TPB) is a development of The Theory of Reasoned Action (TRA). According to Ajzen (1991), Theory of Planned Behavior is a theory based on the assumption that humans will usually behave appropriately. The main difference between TRA and TPB is the third additional determinant of behavioral intention, namely Perceived Behavioral Control (PBC) which is determined by two factors, namely control beliefs and perceived power.

The company's financial position has important implications for the decision to retain or switch auditors. Companies that are bankrupt and experience an unhealthy financial position are more likely to involve auditors who have high independence to increase the trust of shareholders and creditors and to reduce the risk of litigation (Francis and Wilson, 1988). When a company experiences financial distress, the company gets social pressure from stakeholders. If the company's management considers the previous auditor to be incompatible with management's interests and can endanger the loss of stakeholder trust, the company's management will choose to switch auditor instead of losing stakeholders. This is supported by the results of research conducted by Widyanti and Badera (2016), Agiastuti & Suputra (2016) and Kusuma and Farida (2019) which show that financial distress has a positive effect on auditor switching. Based on the description above, the research hypothesis can be formulated as follows:

H₁: Financial distress has a positive effect on auditor switching.

Auditor switching can be related to the growth of the client company which can be seen from the level of sales of the company. In addition to obtaining quality audit results, using the services of a reputable auditor will increase the company's name to stakeholders (Wijayani and Januarti, 2011). When the company is growing, the company needs an independent and high-quality auditor because the company has the intention to gain the trust of stakeholders so that the company tends to switch its auditors. Because if the company does auditor switching, the auditors will be late in auditing the annual fiscal financial statements. Huson et al. (2000) suggests that management needs auditors who are more qualified and able to meet the demands of rapidly growing companies. The results of research from Faradila and Yahya (2016) and Soraya and Haridhi (2017) show that the company's growth rate affects the company's decision to switch auditors. The results of the research by Adha and Noch (2017) show that company growth has a negative effect on auditor switching. Prihandoko (2019) argues that the growth of companies tends to keep old auditors, because as long as the performance provided by auditors is reasonable and accountable, companies do not need to switch their auditors. Based on this, the hypothesis that can be formulated as follows:

H₂: The company growth rate has a negative effect on auditor switching.

A company that has many subsidiaries will usually be more complex than a small company. Woo and Koh (2001) stated that a change in the number of subsidiaries also implies a change in the geographic distribution of the company and the number of industrial sectors in which the company operates. Companies that are more complex have a lower tendency to perform auditor switching on the grounds that the company has the intention to maintain the stability of the company. Huson et al. (2000) stated that a company that purchases a subsidiary will constantly expand its business to the market and carry out auditor changes that are more suitable in providing its audit services. In addition, as the number of subsidiaries increases, the probability of the number of agency conflicts also increases and this may increase the demand for quality-differentiated auditors (Palmrose, 1984). Research conducted by Tanujaya (2018) shows that the company complexity affects the company's decision to switch auditors. This indicates that an increasingly complex company will assign auditors who have the ability and high quality (Calderon and Ofobike, 2008). Wen (2020) states that the complexity of the company has a negative effect on auditor switching. Based on this, the third hypothesis that can be formulated as follows:

H₃: Company complexity has a negative effect on auditor switching.

III. METHODS

This research used quantitative research methods with a descriptive approach. The descriptive research method is carried out to determine the existence of independent variables, either only in one or more variables without making comparisons of the variables themselves and looking for relationships with other variables (Sugiyono, 2017: 35-37). This research was conducted at manufacturing companies listed on the Indonesia Stock Exchange for the period 2015-2019, where the research location was obtained from the website www.idx.co.id. Manufacturing companies were chosen as research locations because manufacturing companies experience more complex operational activities compared to other companies, so the separation between management and owners has increased.

The population used in this study are manufacturing companies listed on the Indonesia Stock Exchange in 2015-2019. The sampling method used was a non-probability sampling method using a purposive sampling approach. Purposive sampling is a sampling technique with certain considerations and obtained a sample of 25 manufacturing companies. The data collection method used in this study is the documentation method by collecting, recording, and reviewing secondary data in the form of audited financial reports and annual reports of Manufacturing Companies listed on the Indonesia Stock Exchange for the 2015-2019 period. The data analysis technique used in this research is logistic regression analysis. Logistic regression is a statistical analysis method to describe the relationship between the dependent variable which has two or more categories with one or more independent variables at the category or interval scale (Hosmer and Lemeshow, 2000).

IV. RESULT AND DISCUSSION

Descriptive statistical analysis is used to describe or explain data on research variables based on the number of samples, the average value (mean), the standard deviation, the maximum value, and the minimum value. The results of descriptive statistical analysis can be seen as follows.

Table 1. Descriptive Statistic Test Results

Variable	N	Min.	Max.	Mean	Std. Deviation
Financial distress	125	-502.13	544.26	94.3183	121.56976
Company growth	125	-5.20	2.95	.0106	.75365
Company complexity	125	0	1	.16	.368
Auditor switching	125	0	1	.62	.486
Valid N (<i>listwise</i>)	125				

Source: Research Data, 2021

Table 1 shows that financial distress (X₁) has a minimum value of -502.13, a maximum value of 544.26, an average value of 94.3183 with a standard deviation of 121.56976 which means that there is a deviation in the value of financial distress on the average value of 121.56976. Company growth (X₂) has a minimum value of -5.20, a maximum value of 2.95, an average value of 0.0106 with a standard deviation of 0.75365 which means that there is a deviation in the value of the company growth in its average value. of 0.75365. Company complexity (X₃) is proxied by a dummy by dividing two groups, namely having 5 or more subsidiaries and less than 5 subsidiaries so that it has a minimum value of 0 and a maximum value of 1. The average value is 0.16 with the standard a deviation of 0.368 which means that there is a deviation in the value of the company complexity at an average value of 0.368. Auditor switching (Y) is proxied by dummy by dividing into two groups, namely companies that change auditors and companies that do not change auditors so that they have a minimum value of 0 and a maximum value of 1. The average value is 0.62 with a standard deviation of 0.486. means that there is a deviation in the value of auditor switching at an average value of 0.486.

Table 2. Hosmer and Lemeshow’s Test Results

Step	Chi-Square	df	Sig.
1	12.963	8	0.113

Source: Research Data, 2021

Based on Table 2, it can be seen that the significance value is $0.113 > 0.05$, so that H_0 is accepted. It means that there is no significant difference between the model and the observed value, so the model used in this study is fit for use.

Table 3. Overall Fit Model Step 0 Test Results

Iteration	-2 Log likelihood	Coefficient Constant
Step 01	167.410	0.432
2	167.409	0.439
3	167.409	0.439

Source: Research Data, 2021

Table 4. Overall Fit Model Step 1 Test Results

Iteration	-2 Log likelihood	Coefficients				
		Constant	Financial Distress	Company Growth	Company Complexity	
Step 1	1	150.955	0.425	0.344	-0.402	-0.712
	2	150.545	0.455	0.392	-0.483	-0.838
	3	150.544	0.455	0.395	-0.489	-0.846
	4	150.544	0.455	0.395	-0.489	-0.846

Source: Research Data, 2021

Table 3 and Table 4 show that there is a comparison between the value of -2 Log likelihood of the first block and -2 Log likelihood of the second block. From the calculation of the value of -2 Log likelihood, it can be seen that the value of the first block (Step = 0) is 167.409 and the value of -2 Log likelihood of the second block (Step = 1) is 150.544. With these results it can be concluded that the second regression model is better, because there is a decrease in value from the first block to the second block.

Table 5. Coefficient of Determination (R^2) Test Results

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	150.544	0.126	0.171

Source: Research Data, 2021

Table 5 shows that the coefficient of determination is 0.171. This shows that 17.1 percent of the variance of the auditor switching variable is influenced by the variance of financial distress, company growth, and company complexity, while the remaining 82.9 percent is influenced by other factors not explained in this study.

Table 6. Multicollinearity Test Results

		Constant	Financial Distress	Company Growth	Company Complexity
Step 1	Constant	1.000	.396	.683	-.391
	Financial distress	.396	1.000	-.015	-.087
	Company growth	.683	-.015	1.000	.098
	Company complexity	-.391	-.087	.098	1.000

Source: Research Data, 2021

Based on Table 6, it can be seen that the correlation coefficient value of each variable used in this study is less than 0.8. This means that there are no symptoms of multicollinearity between the independent variables used in this study, so the regression model can be used.

Table 7. Classification Matrix

	Predicted

		Auditor Switching		Percentage
Step 1	Observed	0	1	Correct
	Auditor switching 0	18	31	36.7
	1	11	65	85.5
	Overall percentage			66.4

Source: Research Data, 2021

Table 7 shows that the predictive power of the regression model to predict auditor turnover is 85.5 percent. This shows that by using the regression model used, there were as many as 65 companies that made auditor switching from a total of 76 companies that should have made auditor switching. The predictive strength of the company model that did not change auditors was 36.7 percent, which means that with the regression model used there were 18 companies that did not switch auditors from a total of 47 companies that should not have made auditor switching.

Table 8. Regression Coefficient Significance Test Results

	Variable	Regression Coefficient	Sig.
Step 1	Financial distress	0.395	0.016
	Company growth	-0.489	0.021
	Company complexity	-0.846	0.033

Source: Research Data, 2021

The financial distress variable (X1) has a positive regression coefficient of 0.395 with a significance value of 0.016. The significance value is $0.016 < 0.05$, so that H_1 is accepted. This means that financial distress has a positive effect on auditor switching. The company growth variable (X2) has a negative regression coefficient of -0.489 with a significance value of 0.021. The significance value is $0.021 < 0.05$, so that H_2 is accepted. This means that company growth has a negative effect on auditor switching. The variable of company complexity (X3) has a negative regression coefficient of -0.846 with a significance value of 0.033. The significance value is $0.033 < 0.05$, so that H_3 is accepted. This means that the complexity of the company has a negative effect on auditor switching.

Table 9. The Formed Logistic Regression Test Results

	Variable	Regression Coefficient	Sig.
Step 1	Financial distress	0.395	0.016
	Company growth	-0.489	0.021
	Company complexity	-0.846	0.033
	Constant	0.455	0.317

Source: Research Data, 2021

Based on Table 9, the formed logistic regression equation is: $\text{Ln} \frac{Y}{1-Y} = 0.455 + 0.395X_1 - 0.489X_2 - 0.846X_3$.

The constant value of 0.455 means that if the value of the variable financial distress, company growth, and company complexity is 0, then the auditor switching value is 0.455. The financial distress variable regression coefficient value of 0.395 means that financial distress has a positive relationship with auditor switching, if financial distress increases by one unit, then auditor turnover will increase by 0.395 units assuming other independent variables are constant. The regression coefficient value of the company growth variable is -0.489 which means that the company growth has a negative relationship with auditor switching, if the company growth increases by one unit, the auditor switching will decrease by 0.489 units assuming the other independent variables are constant. The regression coefficient value of the company complexity variable is -0.846 which means that the company complexity has a negative relationship with auditor switching, if the company complexity increases by one unit, then the auditor switching will decrease by 0.846 units, assuming the other independent variables are constant.

V. CONCLUSION

The conclusion that can be drawn as follows. The greater the financial distress of a company, the more likely it company will make a decision to switch auditors. The greater the growth of a company, the less likely it company will make a decision to switch auditors. The greater the complexity of a company, the less likely it company will make a decision to switch auditors.

This research is only limited to manufacturing companies, so the research results cannot be generalized to all companies listed on the Indonesia Stock Exchange. Future research can select research samples with diverse industrial sectors so that they can better describe the phenomenon of auditor switching. Financial distress in this study is measured by DER ratio, but when collecting and processing data, the researcher realizes that financial distress is not only measured by DER ratio, so it is recommended for further researchers to replace or add other proxies in the financial distress variable and can use Z- Altman scores.

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