"DETERMINANTS OF AUDIT FIRMS SWITCHING AMONG INDONESIAN PUBLIC COMPANIES"

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ABSTRACT

The study aims to examine the factors influencing to audit firms switching in Indonesia. These factors are management turnover, size of the client's firm, client's complexity and client's growth. Research samples are selected by purposive sampling method of 100 public companies listed in Indonesian Stock Exchange. Logistic regression analysis is employed to test the hypothesis. The research result reveals that management turnover and client's growth positively affect towards audit firms switching. Otherwise, the size of the client's firm and client's complexity did not affect to audit firms switching because large companies attempt to avoid public's perception that by switching the audit firms means the company is experiencing financial difficulties, and it takes time for the new audit firms to understand well the state of client's company if switching is occurred.

Keywords: *audit firms switching, management turnover, size of the client's firm, client's complexity, client's growth*

INTRODUCTION Research Background

There are doubts related to the independence of auditor when there is a long working relationship between the Public Accounting Firm (KAP) and the client. The prominent case in Indonesia is the accounting scandal of Kimia Farma Corporation in 20012002 (Kompasiana, 2015) whereas overstated inventory and sales price done by internal accountant of Kimia Farma. It was pass undetected by Kimia Farma's audit firm; Hans Tuannakota & Mustofa (HTM). The HTM is responsible for inability to detect the overstated inventory and sales price done by Kimia Farma; resulting financial report of December 31, 2001 containing the overstated asset was restated in October 3rd, 2002. Whether the inability is due to lack of professional skepticism or objectivity of auditor itself. In addition, the HTM has become the audit firm for Kimia Farma since 1996. This phenomenon sparks the probability of a new idea in Indonesian public's mind that long working relationship between the company and audit firm through the years is may less trustworthy and prone to the accounting scandals. The habit of changing audit firms more frequent than the regulations required is become more trustworthy than its counterpart since it ensures financial report had been audited by different audit firms, and ensure the peace of mind of new investors.

The main consideration is when the company changes the audit firms voluntarily and has sparked investors' attention to find out what factors are decisive for them towards auditor changes. Nazri, Smith, and Ismail (2012) stated that companies attempt to hide the real reasons behind the process of auditor changes (move to another KAP), as they afraid that the disclosure of such changes might provide the first glimpse of potential problems in a company's financial statement and the company's state of affairs. Therefore, a role of public accounting firms as an independent party is needed to mediate both parties (principal and agent) with different interests, which to provide assessment and a statement of audit opinion as the fairness of the financial statements presented (Damayanti & Sudarma, 2007).

According to Damayanti and Sudarma (2007), the increasing of audit service's needs influenced the development of public accountant profession in Indonesia, and it can lead to competition between one KAP with other KAPs, thus allowing companies to move KAP.

LITERATURE REVIEW Agency Theory

Agency issues caused by a conflict of interest and information asymmetry between principle (shareholder) and agent (management) Jensen and Meckling (1976). Conflict of interest may occur in a situation in which a corporation or person with a vested interest in company becomes unreliable because of the clash between personal interest and professional interest. Decisions for auditor change by client firms are due to the principleagent problem of separation of ownership and control of a firm (Nazri, Smith, & Ismail, 2012).

Management Turnover

Management is a crucial position in running the company activities. Generally, management turnover would be followed by policy changes that occur in a company, in Indonesia it is known as RUPS (*Rapat Umum Pemegang Saham*), where the changes also concerned in terms of audit firm selection. Management turnover is perceived influencing the companies towards audit firms switching since the management of company would find the KAP that aligned with its accounting policies and reporting, and more qualified to meet the demands of rapid company growth (Damayanti & Sudarma, 2007). Nazri, Smith, and Ismail (2012) stated that most stakeholders identify management weaknesses as the main cause of the situation and may demand management change in return for their continued support.

Size of The Client's Firm

Large clients are less likely to dismiss their auditors (Haskins & Williams, 1990). It may occur since the prestige value or image of the company has become public assumption that large company will use bigger and higher quality audit firms. In addition, size of the client's firm also indicates the financial capability of company in determining whether to upgrade or downgrade the audit firms. Nazri, Smith, and Ismail (2012) argued that when the company increases in size, this will lead to increased difficulty for owners in monitoring managers' actions as the principals and agents now become more remote

Client's Complexity

Boon, McKinnon, and Ross, (2007) defined complexity as a measurement tool for the difficulties in auditing account balances or classes of transactions which require additional audit period and effort. Large firms usually have more complex operational structure and therefore require expertise from large audit firms to reduce agency cost. The complexity itself can be seen from the number of subsidiaries that company have (Fitriani, 2014).

Client's Growth

The rationalization of the act of replacing the KAP by choosing more qualified KAP is due to the growing company becoming more profitable by using a reputable auditor and it is generally owned by a KAP that is large (Fitriani, 2014). Rapid growth company entails substantial increases in transaction volume and accounting complexity, thus requiring the service of larger audit firms presumably having expertise to provide specialized services. Thus, companies that are consistently acquiring subsidiaries or expanding into new markets would demand auditors who are more effective in providing the audit service.

HYPOTHESIS DEVELOPMENT Audit Firms Switching and Management Turnover

Management is a crucial position in running the company activities. In fact, the contractual relations between the principle (owner) and agents (manager) may prone to conflict. The owners are anxious of high return on their investments, while the managers want high compensation of their performance, thus agents do not always act for fulfilling principal interests (Jensen & Meckling, 1976). In management turnover itself, the new manager may not be satisfied with the quality (and cost) of the previous auditor and requested to change. Besides, the new manager is willing to find out the new auditor, who can deal with certain reporting methods that later on it helps company to be able to show a better finansial result. Management turnover referred consist of a change of board of directors, financial controller, director, and audit committees (Nazri, Smith, & Ismail, 2012). Agency theory views the relationship between the auditor and the client into an engagement contract and a change in the agent contract's principal, as a result of the appointment of the new manager (agent), may trigger an auditor change (Nazri, Smith, & Ismail, 2012). Nazri, Smith, and Ismail (2012) and Wijayani and Januarti (2011) provided the empirical evidences that management turnover positively affect towards audit firms switching.

H_1: Management turnover positively affect the audit firms switching Audit Firms Switching and Size of The Client's Firm

Nazri, Smith, and Ismail (2012) stated that when the company increases in size, this will lead to increased difficulty for owners in monitoring managers' actions as the principals and agents now become more remote. Consequently, the level of agency costs will also increase and the company may require a higher quality auditor to provide better monitoring. Increasing size is also related to a higher delegation of duties which can be associated with "loss of control" by the owner over employees' actions. In this situation, agency theory correlates to the increasing number of agency relationships, thus the company may engage a higher quality audit firms as a way to diminish the possible "loss of control". Therefore, given that auditor change is inevitable, a larger company is expected to engage a higher quality auditor. Nazri, Smith, and Ismail (2012) and Juliantari and Rasmini (2013), provided the empirical evidences that the size of a company positively affect audit firms switching.

H_2: The size of the client's firm positively affect the audit firms switching Audit Firms Switching and Client's Complexity

Large firms usually have more complex operational structure and therefore require expertise from large audit firms to reduce agency cost. The complexity itself can be seen from the number of subsidiaries that company have (Fitriani, 2014). A change in the number of subsidiaries may also mean a change in the company's geographical dispersion and the number of industrial sectors in which it operates (Woo & Kooh, 2001). The increasing number of subsidiaries that company have would reflect to the increasing complexity of its company. Therefore, based on agency theory, the company of higher complexity tends to change the audit firms, which can adjust the company's condition and provide better control so the interests of company can be achieved. Nazri, Smith, and Ismail (2012) and Fitriani, (2014), provided the empirical evidences that number of subsidiary companies operated in company positively affect to the audit firms switching

H_3: Client's complexity positively affect the audit firms switching Audit Firms Switching and Client's Growth

When company increases the size and expanding the market, the number of agency relationships also increased. Thus, companies that are consistently acquiring subsidiaries or expanding into new markets would demand auditors who are more effective in providing the specialized audit service. According to Nazri, Smith, and Ismail (2012), a new contractual agreement may need to be created since there is a possibility that the expanding company would bring in new management or the company may need to hire more employees, which in turn will result in control becoming more remote. Based on the exposure, it can be concluded that the growing company will tend to choose auditors who qualified and able to meet the company's demands. The companies with high growth rates will tend to change the auditor (move the KAP) (Nazri, Smith, & Ismail, 2012) and it has also proved positively affect towards audit firms switching by Fitriani (2014), and Nugroho and Ghozali (2015).

H_4: The client's growth positively affect the audit firms switching

RESEARCH METHOD Sample Size and Data Collection

The population on this research is all public companies that listed in Indonesia Stock Exchange in 2010-2016. Sampling technique conducted in this study uses purposive judgment sampling with totaled 100 companies. Purposive judgement sampling is a sample technique which its' basic criteria are set for specific purpose. The sampling criteria for this research are;

1. Companies are consistently listed in Indonesia Stock Exchange through 2010-2016
2. Companies that have changed the audit firms in 2010-2016
3. Companies have completely published the information of financial reports, and audited by independent auditor in 2010-2016 4. Ease in accessing research data

Table 1
Purposive Sampling Result

Companies are consistently listed in IDX in 2010-2016	**255**
Companies did not change audit firms	(110)
Company's financial reports are unable to access (error)	(10)
Companies are missing some information related to independent variables*	(35)
Total companies	**100**

The data of management turnover, size of the client's firm and client's complexity, and client's growth are obtained from financial report stated on company's annual report that listed in IDX website in 2010-2016.

Data Analysis

Analysis method used in this research is logistic regression. This method is chosen because the data used in dependent variable is non-metric (dichotomous), otherwise the data in independent variables are the combination of metric and non-metric (Latan, 2014). Because the existence of combination scale in independent variables, it impacted to the unfulfilled multivariate normal distribution assumption. Therefore, the function relates as logistic and no need for data normality assumption on the independent variables. The collective data is analyzed by using SPSS 24.

$$SWITCH = \alpha + \beta_1 MT + \beta_2 CLIENTSIZE + \beta_3 SUBS + \beta_4 GROWTH + \varepsilon$$

Description:

α = Constanta

SWITCH = Audit firms switching
MT = Management turnover
CLIENTSIZE = Size of the client's firm
SUBS = Client's complexity
GROWTH = Client's growth
$\beta_{1\text{-}5}$ = Regression Coefficient
ε = Residual error

SWITCH	Change the audit firms (1) or no change (0)
MT	Equals (1) if the company changed Board of Directors during the preceding audit firms change or (0) otherwise
CLIENTSIZE	Natural logarithm of changes in total assets one year before
SUBS	Number of subsidiaries owned
GROWTH	Changes in sales ratio one year before ($Xt_1 - Xt_2/Xt_2$)
$\beta_1 \dots \beta_4$	Coefficient of the predictor variables

Descriptive Statistics

Table 2
Descriptive Statistics

Variable	N	Minimum	Maximum	Mean	Std. Deviation
Audit Firms Switching	700	0	1	0.27	0.442
Management Turnover	700	0	1	0.16	0.367
Size of Client's Firm	700	5	19	10.22	2.288
Complexity	700	0	72	5.21	9.072
Client's growth	700	-100.000	3397.986	35.276	214.559

The test results are shown on Table 2 is based on the number 700 data samples (N) companies listed in Indonesian Stock Exchange 2010-2016. The result of descriptive statistics analysis towards audit firms switching shows that minimum and maximum value of 0 and 1 respectively, the mean value of 0.27 and the standard deviation of 0.442. Management turnover variable has the minimum and maximum value of 0 and 1 respectively, the mean value of 0.16 and the standard deviation of 0.367. The size of the client's firm (natural logarithm of total asset) variable has the minimum and maximum value of 5 and 19 respectively, the mean value of 10.22 and standard deviation value of 2.288. Client's complexity variable has the minimum and maximum value of 0 and 72 respectively, the mean value of 5.21 and standard deviation value of 9.072. The client's growth (percentage of net sales) has the minimum and maximum value of -100% and 3397.98% respectively, the mean value of 35.276% and standard deviation value of 214.559%. There is a company that suffered losses with minimum value at -100.000%.

Logisstic Regression

Table 3
Logistic Regression Coefficient Test Result

Independent Variables	B	Sig. (2-tailed)	Sig. (Converted to 1-tailed)
Management turnover	,676	0.002	0.001
Size of The Client	-,031	0.440	0.220
Client's complexity	-,011	0.343	0.171
Client's growth	,001	0.051	0.025

Based on the table above, the independent variables that positively affected the dependent variable of audit firms switching are Management turnover (with p-value at

0.001 and positive regression coefficient at 0,676) and client's growth (with p-value at 0.025 and positive regression coefficient at 0,001). It can be concluded that the variables of Management turnover and client's growth are successfully proved as the determinants of audit firms switching. The variables of the size of the client's firm and client's complexity resulted significance value higher than 0.05, which concludes that these variables are not supported by the hypothesis and theory used.

DISCUSSION

The research results show that that Management turnover (X1) and client's growth (X4) positively affect to the audit firms switching. While the size of the client's firm (X2) and client's complexity (X3) did not have any influence to audit firm switching. Management Turnover (X1) is proved as one of determinants of the reasons why company switches their audit firms. As can be seen in Table 3, management turnover has the least significant value, it means this independent variable is the most influencing variables among others in this study. This finding is in line with Nazri, Smith, and Ismail (2012) and Wijayani and Januarti (2011) that reveals the new manager tends to change the auditor would be reflecting to the previous audit service quality that might not accordance with his or her satisfaction and standards. However, this finding is contradicted with the previous study conducted by Wijayanti (2010), which found that the policy and accounting report of previous audit firms can still be adjustable with the policy of new manager by conducting renegotiating between them, and this situation is closely related to the companies which majority is controlled and run by people in a family.

The size of the client's firm (X2) variable is proved to have insignificant effect towards audit firms switching. This finding is contradicted with the previous study by Nazri, Smith, and Ismail (2012) and Juliantari and Rasmini (2013), which found that size of the client's firm is one of determinants for companies to switch the KAP. This finding is in line with Wijayani and Januarti (2011) and Fitriani (2014), found that size of the client's firm did not positively affect the companies to switch the audit firms. According to Wijayani and Januarti (2011), The factor would might due to most of samples obtained are big companies that already using the service of Big-10 audit firms, which also found in this study. It is reflecting to professionally and specialized in providing good and quality in audit services, thus the small companies in this study remain using smaller audit firms and tend to not changing their auditor. Other factors also found in article of Ward (2014), he stated that size of the client's firm may negatively affect towards change of audit firms switching because new auditor in new KAP needs to understand the client. It takes time to understand the state of client's company if switching is occurred. Large companies are considered to have big business risk, as well as to maintain perceptions in the capital market. If the company switches the audit firms then the public suspects that the company is experiencing financial difficulties. However, even the size of the client's firm is found to be not affecting the company to switch the audit firms, but it may have influence with the support of other variables such as return of asset of client.

The client's complexity (X3) is proved insignificant towards audit firm switching. This finding is contradicted with Nazri, Smith, and Ismail (2012) and Fitriani (2014), which found that client's complexity is one of determinants for companies to switch the KAP. Based on researcher's opinion, the different result may due to different proxies used, Nazri, Smith, and Ismail (2012) and Fitriani (2014) use dummy variable by determining the company which have more than 5 subsidiaries is more complex than less of it. However, this study focusses in determining whether or not the increasing number of subsidiaries may affect the company to switch the audit firms. This finding is line with Palmrose (1984) and other Indonesian researcher, Handini (2017), that proved client's complexity did not have association towards auditor firms switching. According to her, the increasing complexity of company will also increase to the number of agency relations. It creates more difficulties for owner in monitoring management's activities or debt holders in monitoring owner and management actions through the increasing of needs to more independent auditor (audit firms). Therefore, it takes time for new audit firm to understand well the financial condition, client's business units, and also the policies applied in client's company. However, even if the client's complexity is found to be not affecting the audit firms switching, somehow it may have influence with the support of other variable such as financial distress.

Client's growth is proved as one of determinants of the reasons why the company conducts audit firms switching. It supports the researcher's opinion that the growing company will tend to choose auditors who qualified and able to meet the company's demands. This finding is in line with study conducted by Nazri, Smith, and Ismail (2012), Fitriani (2014), and Nugroho and Ghozali (2015) that reveals when company is expanding into new markets would demand auditors who are more effective in providing the specialized audit service. However, this finding is contradicted with study conducted by Wijayanti (2010), founds that there is no guarantee of company that experiencing growth can separate from its financial problem. Thus, the management strives to maintain the reputation of company, which reflects to the size of KAP that the owner may think it is still the main factor to the company to use the previous KAP.

CONCLUSION

This study aims to prove an indication of a positive relationship between management turnover, the size of the client, client's complexity, and client's growth toward audit firms switching. The data obtained from public companies listed in Indonesian Stock Exchange from 2010-2016, prove that management turnover and client's growth positively affect towards audit firms switching. The new manager tends to change the auditor reflecting the previous audit service quality that might not accordance with his or her satisfaction and standards. Growing company changes the economies scale that previously available to the incumbent auditor, who may now not able to accommodate the expansion at acceptable costs. In this study, the size of the client and company's complexity did not positively affect the audit firms switching, because large companies are considered to have small business risk, as well as to maintain perceptions in the capital market. If the company switches the audit firms then the public suspects that the company is experiencing financial difficulties and also it takes time for new audit firm to understand well the client's financial condition, client's business units, and also the policies applied in client's company.

Those findings can be a source of input for determinants of audit firms switching among Indonesian public companies. However, although size of the client's firm and client's complexity is found to be not influenced, it is still necessary to fully consider by investors or other financial report users regarding the reasons behind the public companies switched the auditor.

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