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Case Auditor Change in Indonesia

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Abstract: This study aims to analyze the effect of profitability and corporate financial distress on auditor turnover in Indonesia. This study uses descriptive and verification methods with a quantitative approach. The population used in this study are 56 annual financial statements of Manufacturing Companies in the Pharmaceutical Sub-Sector which are listed on the Indonesia Stock Exchange. The results showed that profitability had a significant effect on auditor turnover. This shows that the profitability of a developed company has large funds to replace a better auditor. While the company's financial difficulties have no significant effect on auditor turnover, which means that the change of auditors will ensure the company's financial condition so that auditor changes will not be carried out when the company is in financial difficulty. The impact of this research, manufacturing companies can consider carefully in making decisions to change auditors.

Keywords: Profitability, Company Financial Distress, Auditor Change.

1. Introduction

Auditor rotation is related to the company's actions to change auditors (auditor switching). One of the benchmarks for a company to change auditors is profitability. Because the company's financial performance is getting better, the company feels able to pay for another KAP which may have better quality than the KAP it uses. The company's financial distress (financial distress) is a company condition that is experiencing financial difficulties or is threatened with bankruptcy. In this situation, a company will generally tend to change auditors. The condition of client companies experiencing financial difficulties tends to have an impact on increasing caution and evaluating auditor subjectivity.

[1] state that bankruptcy will not occur if the company is able to anticipate and make strategies to deal with bankruptcy if bankruptcy actually occurs to the company. The company's financial difficulties are measured or proxied by using DER (debt to equity ratio), which is a ratio that describes the company's ability to meet all of its obligations with its own capital. The larger the DER ratio indicates a larger composition of debt than equity, which indicates the deteriorating performance of the company.

[2] which states that profitability can affect auditor turnover if the company obtains an increase in profitability, the company experiences growth in its company, thus companies that are experiencing growth will tend to make changes.

This research expands the object and population from several previous studies. [3], suggest that profitability has an effect on auditor turnover, [4] company financial difficulties have a positive effect on auditor turnover. Meanwhile, according to [5] and [6], the company's financial difficulties have a negative effect on auditor turnover. [7] in their research found that the company's financial difficulties had no effect on auditor turnover. Meanwhile, [8] explain that profitability has no effect on auditor turnover. This study aims to empirically test the profitability and financial difficulties of companies on auditor turnover, using descriptive and verification methods.

2. Method

The reason the researcher uses the descriptive and verification methods is because they want to describe and test the effect of profitability and company financial difficulties on auditor turnover, and test the theory by testing a hypothesis whether it is accepted or rejected. The data in this study uses secondary data. The data in this study used secondary data. The data is obtained from the financial statements of the Pharmaceutical Sub-Sector Manufacturing Companies listed on the Indonesia Stock Exchange in the period 2007-2014.

The population used in this study is 56 annual financial statements of Manufacturing Companies in the Pharmaceutical Sub-Sector which are listed on the Indonesia Stock Exchange in the period 2007-2014 which consist of balance sheets and income statements.

The researcher used purposive sampling method. So the number of samples used in this study were 56 Financial Statements of Manufacturing Companies in the Pharmaceutical Sub-Sector for the period 2007 to 2014 which came from 10 company units.

In this study, logistic regression was used to examine the effect of profitability and company financial difficulties on auditor turnover. The logistic regression model in this study is as follows:

$$\text{(1)}\quad \mathrm{Ln}\,\frac{P}{1-P} = a + b_1 ROA + b_2 DER + \varepsilon$$

$\mathrm{Ln}\,\frac{P}{1-P}$	=	Auditor Change
ROA	=	Profitability
DER	=	Company Financial Difficulties
a	=	constant
ε	=	Error Term

Hypothesis testing was carried out by multivariate analysis using logistic regression, in which the independent variable was a combination of metric and non-metric (nominal). This analysis technique no longer uses the normality test and the classical assumption test on the independent variables [9].

3. Results and Discussion

he logistic regression equation that explains the effect of the company's profitability and financial distress on auditor turnover is as follows:

$$\mathrm{Ln} = -4.780 + 5{,}005\ ROA + 1{,}274\ DER$$

The estimated value of the logistic regression presented in the regression equation above cannot be interpreted directly as in the usual linear regression model, but the estimated value of the logistic regression equation can be interpreted from the value of Exp(B) or commonly referred to as the odds ratio value. The interpretation of the odds ratio value obtained is as follows:

1. The odds ratio for ROA is 149.225 with a positive regression coefficient which indicates that the higher the company's ROA, the more likely the company to change auditors will increase by 149.225
2. The odds ratio for DER is 3.574 with a positive regression coefficient which indicates that the higher the company's DER value, the company's opportunity to change auditors will increase by 3.574.

The model's feasibility test (goodness of fit) is needed to ensure that there are no weaknesses in the conclusions of the logistic regression model obtained. To validate the fit of the model used Hosmer and Lemeshow's Test,

Hosmer and Lemeshow test results can be seen in the table 1:

Table 1
Hosmer and Lemeshow's Test

Step	Chi-square	df	Sig.
1	5,956	7	0,545

Source: Results of data processing

In table 1 above, it can be seen that the significance value obtained is 0.545, much greater than 0.05, so that according to the test criteria it can be decided to accept Ho and reject Ha, which means there is no difference between the observed data and the model formed. so that the model can be said to be fit or in other words the model has been able to predict the value of its observations correctly.

This Wald test is used to partially test the hypothesis as in the linear regression model. The results of hypothesis testing are presented in the table 2:

Table 2. Wald Test (Partial) Effect of ROA on Auditor Change

Variabel	Wald	χ^2_{tabel}	Sig.	α	Keputusan	Kesimpulan
$X_1 \rightarrow Y$	3,918	3,841	0,048	0,05	Ho ditolak	Signifikan

Source: Results of data processing

In table 2 above, it can be seen that the significance value obtained is 0.048 and less than 0.05, so with a 95% confidence level it was decided to reject Ho and accept Ha. These results show that ROA has a significant effect on auditor turnover.

The results of hypothesis testing are presented in the table 3:

Table 3. Wald Test (Partial) Effect of DER on Auditor Change

Variabel	Wald	χ^2_{tabel}	Sig.	A	Keputusan	Kesimpulan
$X_2 \rightarrow Y$	1,945	3,841	0,163	0,05	Ho diterima	Tidak Signifikan

Source: Results of data processing

In table 3 above, it can be seen that the significance value obtained is 0.163, much greater than 0.05, so with a 95% confidence level it was decided to accept Ho and reject Ha. These results show that DER does not have a significant effect on auditor turnover.

4. Discussion

The Effect of Profitability on Auditor Changes

There is a positive relationship between profitability and auditor turnover. That is, profitability has a strong relationship with auditor turnover and it can be said that profitability is proportional to auditor turnover. Where if profitability increases, the company will change auditors because the company has more funds to pay for a new, higher quality KAP. So that there is an influence between profitability on auditor turnover in the Pharmaceutical Sub-Sector Manufacturing Companies listed on the Indonesia Stock Exchange.

The main factor that influences a company to change auditors is profitability, profitability is a ratio that describes the company's ability to earn profits through all capabilities, and existing sources such as sales activities, cash, capital, number of employees, number of branches, and so on [10]. So, in order to earn above-average profits, management must be able to increase revenues and minimize expenses.

The magnitude of the profitability of a company indicates that the company has large funds to replace a better auditor. Research conducted by [11] and [12] concludes that if the company gets an increase in profitability, the company experiences growth in its company, thus companies that are experiencing growth will tend to change auditors.

Research conducted by [13] and [14] states that profitability that affects auditor turnover is measured using ROA. The higher the ROA value, the better the effectiveness of the company's management in managing assets, so that the business prospects will also be better. This will make the company change from a small KAP to a large KAP so that the new KAP can accommodate the expansion that occurs in the company.

The Effect of Company Financial Difficulties on Auditor Change

The results of testing the company's financial difficulties on auditor turnover indicate that this hypothesis cannot be accepted. So there is no relationship between the company's financial difficulties and auditor turnover. This means that the company's financial difficulties do not have a strong relationship with the change of auditors and it can be said that the company's financial difficulties are not proportional to the change of auditors.

Where if the company's financial difficulties increase, the company will not change auditors because the company does not have more funds to pay for a new, higher quality KAP. The company's financial distress is a situation where the company's operating cash flow is not sufficient to pay off current obligations (such as trade payables or interest expense) and the company is forced to take corrective actions. So, the change of auditors will further complicate the company's financial condition and the company will seriously consider the decision to change auditors [15][16].

The magnitude of the level of financial difficulty of a company indicates that the company chooses an engagement with the old auditor who already knows the company's financial condition to increase the confidence of shareholders and creditors.

Research conducted by [17] and [18], companies in financial distress tend not to change KAP this is due to changing auditors in a company that is too frequent to increase audit fees. When auditing a client for the first time, the first thing the auditor does is understand the client's business environment and the client's audit risks.

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This results in high start-up costs and can increase audit fees. In addition, the first assignment will also allow for high errors. An effort to maintain investor confidence and attract interest in investing is to use a KAP which has the ability to produce higher audit quality and is more independent.

5. Conclusion

Profitability has a significant effect on auditor turnover while the company's financial difficulties do not have a significant effect on auditor turnover in Manufacturing Companies in the Pharmaceutical Sub-sector listed on the Indonesia Stock Exchange for the period 2007-2014.

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