CHAPTER I

INTRODUCTION

A. Background

A company records its' financial activities in the form of a financial statement. Financial statements can be defined as the financial reports that summarize the effects of events on a business. Financial statement contains the overall performance of the company that will be used as the basis for the company to decide their future management and activities. The financial statement can also used by the principals, in this case the shareholders, to understand the company's performance in running its' business.

However, there may be an inconsistency between the principal information regarding the company's performance with the actual company's condition that is known by the management. This inconsistency is called as information asymmetry, which occurs when one side, often the management, has more information than the other, which is the principals or shareholders. The inconsistency may lead to the idea in the principals' minds that the company and the management are hiding information from them.

To settle the information asymmetry, a third party is needed to solve it. This is where auditor or audit firm steps in. Audit firm checks and ensures the eligibility of the company's financial statements and its compliance with the generally accepted accounting principles or GAAP. Audit firm works so that the company can ensure that their and the principals' information match one another without any hidden information of sort and able fulfil their interest.

In order to maintain consistent information and regulation, every so often company may switch their audit firm to a new one, this is what we called as auditor switching. According to Kasih and Puspitasari (2017), Auditor Switching is an event of changing public accounting firm. Based on its characteristics, auditor switching can be classified into two categories, those are *Voluntary* or *Mandatory*. Voluntary auditor switching is the change of auditor solely based on the decision of the client company. Mandatory auditor switching is the change of auditor or audit firm because of the rules set by the government.

According to Keputusan Menteri Keuangan No.359/PMK.06/2003, a company must change their public accounting firm for audit purpose if they had work together for the last 5 years and their public accountant after 3 year. This is renewed in Keputusan Menteri Keuangan No.17/PMK.01/2008, which states that a company must change their public accounting firm for audit purpose after working together for 6 years in a a row as oppose to the previous 5 years and their public accountant after 3-year work in a row.

Although stated in Keputusan Menteri Keuangan No. 17/PMK.01/2008, numerous companies neglect their work and break the auditor work ethics. One instance is from Enron corporation with Arthur

Andersen audit firm. Enron faked their financial information and even pressured their audit firm to ignore their deceit. Arthur Andersen did not stand their ground and falter in fulfilling their auditor’s ethics in term of independences. This proves fatal as it causes Enron to bankrupt and the dissolvement of Arthur Andersen itself. Thus, this creates a loop hole in which that company may or may not change their public accounting firm for audit purpose regardless whether they implement the regulation.

Auditor must be able to fulfil and reflect the condition of the company’s financial report as a whole as there may be inaccuracy in its reporting. In 2002, Kementerian BUMN and Badan Pengawas Pasar Modal (Bapepam) had to restated the 2001 financial report of PT Kimia Farma Tbk as it had showcased an overstatement of its raw material industry unit. In 2019, PT Garuda Indonesia (Persero) Tbk., had to restated their 2018 financial report due to the fact the company had falsely stated their financial report worth of 180 Million Dollar difference between the initial financial report and the restated financial report.

Although prior case showed us that some company may not change their audit firm for their own benefit, in a certain condition, company may reconstruct its management that could change the whole system of the management. This case could potentially lead to an auditor switching. Previous research done by Faradila (2016) shows that the presence of auditor switching is likely to be seen as a way to help the company in increasing their competitiveness in the market which also pushes the non-big four accounting firms to grow and expand, which places them in the same level and chance with the big four firms.

However, Auditor switching also has its share of problems. The relationship between the auditor and the client may end prematurely. The company may see this as a problem which may end up erasing their work quality, as often new audit firms may not understand fully the business model rather than the previous audit firm. Auditor switching may also lead the company to take bigger starting audit fee for the auditing process for the new audit firm (Prahartari, 2013).

There are several factors that affect Auditor Switching, such as profitability, company's growth, management change, and the company's complexity. Profitability refers to the percentage of profit that the company obtained from their net profit divided by total asset. It shows on the efficiency of a company and how they are able to manage their asset to produce the profit.

Based on prior study done by Wijayanti (2010), the management is more encouraged to change their auditor the higher their profitability is. The management needs to change their auditor is a form of holding up to the principals' expectation towards the company. The higher the amount the profitability is, the more likely the company change their auditor.

Company Growth, the second factor that affects auditor switching, is the increase or decrease of the company's well-being over the time of its running. This study uses the sales growth ratio as the basis for the company's growth. A previous study conducted by Soraya and Haridhi (2017) states that the amount of yearly growth of the client company do in fact affect the increased needs of independent audit change. Companies then are more likely to change their audit firm to a newer one. However, the research by Pamungkas (2018) suggests that company growth does not factor in the probability of the company to change their audit firm. This is because companies that have good yearly company growth rate tend to keep their old audit firm resulted from the management consideration. The management thinks that the companies are in good condition that changing their audit firm will not be required.

Management change refers to the condition in which the company decides to rearrange their management, board of director, and board of commissioner. If the company change their management, they are more likely to apply new policies and rules that are in line with the new management style. One of the changes is the change of audit firm that the company works with. According to Andra (2012), the new management often change their auditor if the current one is deemed incapable of aligning their work with the new policies and rules. Thus, the company is more likely to search for new auditor or audit firm that can work with them.

Company complexity can also influence auditor switching. Company complexity is the amount of complexity of the company regarding their business. According to Nazri et al. (2014) the complexity of a company can be seen by looking at the amount of subsidiary company that the parent company has. The higher the number of the subsidiary is, the more complex the company is. A study done by Pratitis (2012) states that company complexity does not have any effect toward auditor switching. The result shows that company tend to retain their current audit firm as to oppose replacing with a new one to decrease the amount of agency cost that the company receive. Oppose to that study, Tanujaya (2016) proves the opposite. The result of his study states that the company complexity variable has a significant effect toward auditor switching.

. Several previous researches solely based their research by only viewing the companies found in the stock market as a general without limiting the research to only a certain type of company. Sharia compliant companies are currently the most interesting market viewed by the general public and traders. The sharia compliant company may have a different outtake of auditor switching as opposed to the previous research which use a variety of companies, including both sharia and non-sharia compliant companies. Because of this, no other research had found out whether there is a different take of company's decision in changing its audit firm in sharia compliant company. This proves that there may be a difference in result found in this research with other researches.

This research is a replication from previous research done by Selvanus (2021) "Pengaruh Pergantian Manajemen, Ukuran Perusahaan, dan Pertumbuhan Perusahaan Terhadap Auditor Switching Pada Perusahaan Manufaktur Yang Terdaftar Di Bursa Efek Indonesia". The research adds profitability variable referring to prior research from Susilowati (2017). This study focuses on the company in the industrial sector, are Sharia compliance and are listed in the Index Saham Syariah Indonesia or ISSI for the period of 2018-2022.

Based on the background above and previous research, the author wishes to further study the idea in the form of undergraduate thesis entitled: "**The Influence of Profitability, Company Growth, Management Change, and Company Complexity Towards Auditor Switching**"

B. Research Scope

The scopes of this research are:

1. The variables used in this research as an independent variable were profitability, company growth, management change, and company complexity. The dependent variable used for the research was auditor switching.
2. Samples used in the research were companies listed in Indonesia Stock Exchange and publish their annual report for the year 2018-2022.

C. Research Questions

1. Does profitability have a significant positive effect toward auditor switching?
2. Does company growth have a significant positive effect toward auditor switching?
3. Does management change have a significant positive effect toward auditor switching?
4. Does company complexity have a significant effect toward auditor switching?

D. Objectives of the Study

1. To obtain empirical evidence of the effect of profitability toward auditor switching
2. To obtain empirical evidence of the effect of company growth toward auditor switching
3. To obtain empirical evidence of the effect of management change toward auditor switching
4. To obtain empirical evidence of the effect of company complexity toward auditor switching

E. Significance of The Study

The benefits expected from the research are as follows:

1. Theoretical Benefit
    a. This research is expected to give some benefits in the form of new knowledge and understanding about the factors that influence the company to do auditor switching.
2. Practical Benefit
    a. For academic, the research can be used as a reference for the next research that are associated with audit delay and its factors.
    b. For auditor, this research can be used as a reminder for them as a basis on the overall likelihood for them to changed and as an insight for future partnership.
    c. For company, the research can be used as a reference and determine the overall likelihood of their own company and others to do auditor switching and use it as a comparison basis.