

Analysis of Factors Affecting Auditor Switching on Manufacturing Issuers

Wasito¹, Siti Maria Wardayati^{2*}, Nining Ika Wahyuni³, Dwi Indriani Fidiastutik Wijaya⁴, Dinda Putri Wulan Sari⁵

^{1,2,3,5} Faculty of Economics and Business, University of Jember, Jember, Indonesia

⁴ Master of Accounting Student, Faculty of Economics and Business, University of Jember, Jember

*Corresponding author: siti.maria@unej.ac.id

Abstract

The study is aimed to analyze management substitution, company size, public accounting firm size, financial distress, and auditor specialization on auditor switching. The sample in this study is a manufacturing companies sited on the IDX. The secondary data used is the financial statements that include the auditor's report within 2014 to 2017. The sample obtained through purposive sampling method. This research belongs to a quantitative research. The data analysis technique used is logistic regression analysis. The data that was successfully processed showed that the variables of management substitution company size, public accounting firm size, financial distress, and auditor specialization did not support the occurrence of auditor switching.

Keywords: Auditor Switching, Management Substitution, Company Size, Financial Distress, Auditor Specialization.

Introduction

In 2018, IDX recorded that there were 55 companies conducting IPOs (Initial Public Offering). The term IPO is the first public offering of shares to be carried out in the primary market (Saputra and Suaryana, 2016). PT. The Indonesia Stock Exchange on its official website explains that one of the requirements or documents that must be prepared by companies that will conduct an IPO is the financial statements audited by public accountants registered with the Financial Services Authority (OJK).

An audit of financial statements must be carried out by an independent auditor in order to provide confidence that the company's financial statements are credible and beneficial to the users of financial statements (Wijaya and Rasmini, 2015). Nasser et.al.(2006) states that the independence of an auditor will be lost if the auditor is involved in a personal relationship with clients, because it can affect their mental attitude and opinions. Mohamed and Habib (2013) argue that many parties consider mandatory rotation is the solution of low auditor independence. However, sudden rotation of the auditor or auditor switching can cause suspicion by stakeholders.

The previous studies showed various results regarding the factors that influence auditor switching. Aminah et al (2017), Manto and Manda (2018) show that management substitution that are proxied by CEO switch have an influence on auditor switching. However, Hartono and Rohman(2015), Harvianto (2015) showed that management Substitution did not have a significant effect on auditor switching probability.

Astuti and Ramantha (2014), Faradila and Yahya (2016) showed that the improvement of company growth causes auditor switching. However, Efendi and Rahayu (2015) stated that clients firm size does not significantly effect on auditor switching.

Hervianto (2015), Manto and Manda (2018) indicated that the size of AKP has an influence on auditor switching. But, Pratini and Santika (2013), Kurniaty (2014) showed that the size of KAP does not affect auditor switching.

Budi Santoso et al (2017), Dwiyanti and Sabeni (2014) found that financial distress effects on auditor switching. However, Salim and Rahayu (2014) 1, Faradila and Yahya (2016) showed that financial distress does not influence auditor switching.

According to Mahdi Safari (2011), auditor specialization is a part of audit quality dimensions, because auditors knowledge and experience on the industry is an important element of auditors expertise. It is indicated to have influence on auditor switching, since it becomes company considerations in selecting KAP that will be used to obtain better audit quality.

The number of various conflicting results of studies and lack of research on the auditor's specialization of auditor switching have motivated researchers to re-examine the factors that affect auditor switching, especially in manufacturing issuers during 2014 - 2017.

By this research, academics, investors and the public are expected to get better information about the factors that influence auditor switching and it can be taken for consideration in making decisions for both investors and investors.

Literature Review

Agency Theory

Jensen and Meckling (1976) express agency relationships as a contract under one or more principals which involve agents to carry out some services for by delegating decision-making authority to agents. Agency relations can arise some problems due to the separation of duties between the owner and management. Effendi and Rahayu (2015) states that through the company's annual report the auditor carries out a monitoring function on the work of management.

Auditor Switching

Auditor switching is an act of switching auditors by the company as an effort to maintain auditor independence and objectivity and maintain public trust in the audit function due to a long engagement period (Farida, 2016). This transfer can be caused by client factors or auditor factors (Juliantari and Rasmini, 2013). According to Ruroh (2016) there are two types of auditor switching, namely: mandatory auditor switching and voluntary auditor switching.

Description of Management

The management substitution includes changes to the board of directors, financial controller, chief director (CEO), and audit committee. The CEO (Chief Executive Officer) himself is a party included in the company's top management who is responsible for the survival and success of the company (Kurniaty, 2014).

The Firm Size

Company size is expressed in total assets, sales, and market capitalization (Harvianto, 2015). The greater components will reflect the greater size of a company. Growing companies will increase demand for higher auditor independence and higher quality audit firms (Faradila and Yahya, 2016).

Size of the Public Accounting Firm

The four KAP ownership categories are divided as follows (Damayanti and Sudarma, 2007): 1. International Public Accountant Firm 2. National Public Accountant Firm 3. Local and Regional Public Accountant Firm 4. Small Local Public Accountant Office. KAP size is classified based on the size of the KAP which is divided into two groups, namely KAP affiliated with The Big Four and KAP that are not affiliated with The Big Four.

Financial Distress

Manda and Manto (2018) explained that financial difficulty is a severe problem that cannot be solved without a change in the size of the company's operations or structure. Companies that are

experiencing financial distress begin with the layoffs or loss of dividend payments, and cash flow that is smaller than long-term debt. Financial ratios become a tool used to analyze the financial condition and performance of a company. Dwiyanti and Sabeni (2014).

Auditor Specialization

A specialist auditors are those who have undergone training courses that focus on a particular industry (Siregar, 2016). Fitriany and Setiawan (2011) state that auditors with industry specialization have better knowledge and understanding about the company's internal control, business risk, and audit risk in the industry.

Effect of Management Substitution on Auditor Switching

According to Nazri et al. (2012) management substitution has a significant impact on auditor switching. In this research management switching is proxied by the change of CEO (Chief Executive Office). The new management has the possibility of dissatisfaction with the quality and cost of the previous auditor, thus requesting a change of auditor. Dwiyanti and Sabeni (2014) stated that new management need a new auditors who are in line with the choices and implementation of their new accounting policies. Regarding the agency theory, the condition is likely to occur because of the interests of "agents" i.e., the management.

Manto and Manda (2018), Aminah et al. (2017) stated management substitution effects on auditor switching. Different results were stated by Hartono and Rohman (2015); Juliantari and Rasmini (2013) that management change has no influence on auditor switching. Thus the hypothesis proposed is H1: Substitution of management affects auditor switching

Effect of Company Size on Auditor Switching

Large companies with the complexity of operations, accounting, and managerial systems require large KAP compared to smaller companies to reduce agency cost and auditor's personal profit (Hartono and Rohman, 2015). Large companies caused difficulties for principals to supervise the actions of agents who have the possibility of maximizing personal profit rather than principal profit (Juliantari and Rasmini, 2013). Developing companies are likely to make auditor switching because they need better auditors to improve the prestige of the company and its shareholders (Faradila and Yahya, 2016).

Astuti and Ramantha (2014), and Kurniaty (2014) prove that company size influences auditor switching. The results of this study are not supported by Rasmini (2015) whose results show that client company size has no influence on auditor switching. Thus the hypothesis proposed is H2: Firm size influences auditor switching

Effect of KAP Size on Auditor Switching

Damayanti and Sudarma (2007) stated that companies need KAPs with high credibility to increase the credibility of their financial statements. Larger firms are generally considered to provide high audit quality and maintaining a reputation in the business environment, so that they will try to maintain their independence to strengthen the image (Nasser et al, 2006). When a company has chosen the Big Four KAP, the client company will maintain it wherever possible. Expertise KAP becomes one of the attributes in the services provided. The existence of this expertise factor is considered to determine auditor changes by the company (Aminah et al., 2017).

Aminah et al. (2017), Harvianto (2015) proves that KAP size has an influence on auditor switching. Kurniaty (2014), Pratini and Astika (2013) show that the KAP size has no effect on the change of auditors. Thus the hypothesis proposed is H3: KAP size influences auditor switching.

The Effect of Financial Distress on Auditor Switching

Financial distress is a condition where the amount of earnings per share owned by the company is in a negative position. Low earning per share of a company is caused by the received income in

the period is smaller than the costs incurred (Agus et al., 2014). Dwiyanti and Sabeni (2014) stated companies with higher financial difficulties tend to change KAPs compared to healthier companies to maintain stakeholder trust and increase company confidence.

Manto and Manda (2018), and Harvianto (2015) prove that financial distress has an influence on auditor switching. However, Faradila and Yahya (2016) and Kurniaty (2014) showed that financial distress has no effect on auditor switching. Thus the hypothesis proposed is: H4: Financial disress affects auditor switching

Effect of Auditor Specialization on Auditor Switching

Panjaitan (2014) revealed that specialist auditors are more likely to detect errors and irregularities than non-specialist auditors so that they have better audit quality. Companies audited by specialist auditors have lower discretionary accrual values than non-specialist auditors (Panjaitan, 2014). The company or client chooses to work with specialist auditors with the aim of reducing the risk of sanctions from the IDX due to material misstatement.

Based on the above opinions, the researcher concludes that the company is motivated to do auditor switching to work with auditors having certain industry specializations. The purpose of choosing specialist auditors is to obtain better audit quality, and the desire to increase the confidence of stakeholders in the financial statements presented. Thus the hypothesis proposed is H5: Specialization of auditors influences auditor switching

Research Method

Type of Research

This type of research is explanations and the approach used is a quantitative approach.

Population and Sample

The population in this study is manufacturing issuers during 2014-2017. The sample selection uses a purposive sampling method with predetermined criteria, namely:

Table 1. Purposive Sampling Method

No	Sampling Criteria
1	manufacturing issuers during 2014-2017
2	Issuer presents complete information that supports the research such as: change of management, KAP size, issuer size, financial distress, auditor specialization
3	Issuers have changed KAP during the period 2014 - 2017
4	Issuers issue financial statements in rupiah

Type and Source of Data

The data used in this study are secondary data obtained from the financial statements of manufacturing issuers during 2014 - 2017. The financial statements of issuers are obtained from the Indonesia Stock Exchange website (www.idx.co.id) and (www.idnfinancials.com).

Definition of Research Variables

The dependent variable in this study is auditor switching (Y) voluntarily. Auditor switching is a change of auditor and KAP made by a company in the next period. this variable (Y) is measured using a dummy variable. Code 0 indicates the company does not do auditor switching and code 1 means the company do auditor switching

The independent variables in this study are:

- a. Management Substitution (X1)

The substitution of management in this study was proxied by the change of CEO (Chief Executive Office) or Managing Director. CEO (Chief Executive Officer) is a party included in the company's top management. The management change variable is measured using a dummy variable. Code 0 if the company does not change management and code 1 if the company changes management.

b. the Firm size (X2)

Firm size is the size of a company in total assets, sales, and market capitalization. Based on Nurdjanti (2017) stating that the size of the company is proxied by the total assets owned by the company and then converted to natural logarithms so that the data obtained is not too large. Client Company Size = LN (Total Assets), SIZE = natural log Total Assets

c. the size of KAP (X3)

KAP size in this study is divided into two categories namely, KAP affiliated with the Big Four and KAP that are not affiliated with the Big Four. KAP size variables in this study were measured using dummy variables. Code 0 for companies that are not audited by the Big Four KAP and code 1 for companies that are audited by the Big Four KAP

d. Financial distress (X4)

This study uses financial distress variables that are proxied by DAR (Debt to Assets Ratio) which is dividing the total assets of the company by the total liabilities of the company.

$$\text{DAR (Debt to Asset Ratio)} = \frac{\text{Total Debt}}{\text{Total Asset}}$$

e. Industry Specialization (X5)

Suresti (2015) states that specialist and non-specialist auditors can be categorized based on data on the percentage of public company clients audited by KAP in certain industries, then weighted on the company's total assets with the formula developed by Siregar et al., (2009) as follows:

$$\text{SPEC} = \frac{\sum \text{KAP client in the industry}}{\sum \text{issuer in the Company}} \times \frac{\Delta \text{asset of KAP client}}{\Delta \text{assets of all listed industrial companies}}$$

Δassets of all listed industrial companies

The auditor or KAP industry specialization is seen through a market share of ≥10% of the audited client company in a particular industry (Suresti, 2015). Auditor specialist variables are measured by dummy variables. Code 0 for client companies audited by non-specialist auditors and code 1 for client companies audited by specialist auditors.

Results and Discussion

Descriptive statistics

Descriptive statistics in this study include the mean, median, mode, and frequency table of respondents tested using 23 version of SPSS (Statistical Package for Social Science).

Based on the results of the descriptive statistics, 144 data can be obtained which are the results of multiplication between the number of samples used of 36 companies and the research period for 4 years (2014 - 2017).

Table 2. Auditor Switching Descriptive Statistics

No	Explanation	Sum	Percentage
1.	Doing Auditor Switching	52	36,1%
2.	Not doing Auditor Switching	92	63,9%
Total		144	100%

Source: Secondary data, processed in 2019

The results showed that there was 36.1% of companies doing auditor switching, while 63.9% showed that the company did not conduct auditor switching of all samples of manufacturing listed companies during 2014 - 2017.

Table 3. Descriptive Statistics of Management Substitution

No	Explanation	Sum	Percentage
1.	Doing Management Substitution	16	11,1%
2.	Not doing Management Substitution	128	88,9%
Total		144	100%

Source: Secondary data, processed in 2019

The results showed that there was 11.1% of the sample of companies that made management changes, while 88.9% of the total sample of companies did not make changes in management during 2014 - 2017.

Table 4. Descriptive Statistics of Company Size

	N	Min	Max	Mean	Std. Deviation
SIZE (Firm)	144	24,40	30,68	27,7749	1,37671
Valid N (list wise)	144				

Source: Secondary data, processed in 2019

The results of descriptive statistical analysis of company size variables obtained a minimum value of 24.40 and a maximum of 30.68 with a mean of 27.7749 and a standard deviation of 1.37671. Based on the results, the company that has the lowest company size in this study is PT. Siwani Makmur Tbk during the 2014 – 2017 period. The company with the highest company size is PT. Japfa Comfeed Indonesia Tbk during the period of 2014 – 2017.

Table 5. Descriptive Statistics of KAP Size

No	Explanation	Sum	Percentage
1.	KAP Big Four	13	9,0%
2.	KAP non- Big Four	131	91,0%
Total		144	100%

Source: Secondary data, processed in 2019

The results showed that there was 9.0% of the sample companies using auditors or KAP affiliated with Big Four KAP, while 91.0% of all sample companies used non-Big Four KAP auditors during 2014 - 2017.

Table 6. Descriptive Statistics Specialization Auditor

No	Explanation	Sum	Percentage
1.	Specialist Auditor	56	38,9%
2.	Non-Specialist Auditor	88	61,1%
Total		144	100%

Source: Secondary data, processed in 2019

The results showed that there was 38.9% of the sample of companies that used specialist auditors, while 61.1% of the total sample of companies did not use specialist auditors.

Multicollinearity Test

Table 7. Multicollinearity Correlation Matrix Test

		Constant	Management Switching	Firm Size	KAP Size	Financial Distress	Auditor Specialist
Step 1	Constant	1,000	-,084	-,990	-,375	-,145	-,591
	PM (1)	-,084	1000	-,003	-,126	-,030	,070
	SIZE	-,990	,003	1000	,300	,106	,580
	KAP (1)	-,375	-,126	,300	1000	,035	-,044
	DAR	-,145	-,030	,106	,035	1000	,013
	SPEC (1)	-,591	,070	,580	-,044	,013	1000

Source : SPSS 23 output, 2019

The results shown in Table 7 explain that there is no correlation coefficient above 0.90 between independent variables. (Ismaya, 2019) Based on these results it can be concluded that there is no multicollinearity between independent variables in this regression model.

Classification Matrix

Tabel 8. Classification Matrix

Observed		Prediction		Accuracy Percentage
		Auditor Switching Not doing	Doing	
Auditor Switching	Not Doing	91	1	98,9%
	Doing	48	4	7,7%
Total Percentage				66,0

Source : SPSS 23 output, 2019

Based on Table 8 the classification accuracy of the regression model used is 66%. According to the prediction there are 52 companies that do auditor switching, while the observation results show there are only 4 companies. So the power of the regression model to classify companies that do auditor switching is 7.7%. The prediction of companies that do not do auditor switching is as many as 92 companies, after observation found 91 companies. So the power of the regression model to classify companies that do not do auditor switching is 98.9%.

Formed Regression Model

Table 9. Results of Logistic Regression Test Variables in the Equation

		B	S.E.	Wald	Sig.	Exp (B)
Step 1 ^a	Management Switching	-,268	,547	,240	,624	,765
	Firm Size	-,166	,173	,920	,336	,847
	KAP Size	-,765	,649	1,392	,238	,465
	Financial Distress	-,072	,392	,034	,854	,930
	Auditor Specialist	,105	,466	,051	,822	1,111
	Constant	4,955	,5218	,902	,342	141,874

Source: SPSS 23 output, 2019

Explanation:

B = Regression Coefficient

S.E = Error Standard

Wald = partial testing of independent variables

Sig = Significant (Effect of independent variables on the dependent)

Exp (B) = ODDS RATIO (Opportunity Ratio)

Based on the test shown in table 14, the logistic regression equation that is formed is as follows:

$$\text{SWITCH} = 4.955 - 0.268\text{PM} - 0.166\text{SIZE} - 0.765 \text{KAP} - 0.072\text{DAR} + 0.105\text{SPEC} + e$$

Based on the logistic regression model formed, it is known that the constant value is positive at 4.955 which indicates that there is a positive relationship that supports the occurrence of auditor switching by management changes, company size, KAP size, financial distress, and auditor specialization.

Discussion

The Effect of Management Substitution on Auditor Switching

This study states that the first hypothesis is a change of companies that has an influence on the occurrence of auditor switching. The regression coefficient value obtained from the management change variable is -0.268 with a significance value of 0.624. At the level, the regression coefficient is not significant because the value is $0.624 > 0.05$, thus it is identified that "H1: Management substitution affects auditor switching" is not supported by the data

The research supports Hartono and Rohman (2015) and Juliantari and Rasmini (2013). CEO switching that occurs does not always cause a change in the auditor of the company concerned. This is also supported by Kurniaty (2014) which states that old KAP accounting policies and reporting are still able to be harmonized with new management policies through renegotiation.

Harvianto and Azhar A (2015) also explained that the average company listed on the IDX did not recruit new people to replace the previous management position. Companies are more inclined to recruit people within the scope of the company based on the trust that has been built. The fear of the company on difference ideas and opinion with the new management is also influential fact for not recruiting people outside the company. This phenomenon is also closely related to the state of public companies in Indonesia, which are mostly controlled and run together by one family (Damayanti and Sudarma, 2007).

The above explanation reinforces the possibility of not doing auditor switching even though the company experienced a management change which in this study was proxied by a CEO switching. The selection of people in the company makes it possible to renegotiate with third parties (auditors) if there are accounting policies or accounting reports that are not appropriate beforehand. In addition, the change of Public Accounting Firm sometimes requires a general meeting of shareholders, so that new management desires are sometimes not fulfilled (Astrini and Muid, 2013).

Effect of Company Size on Auditor Switching

This study states the size of the company has a significant influence on the occurrence of auditor switching. The regression coefficient value obtained from the management change variable is -0.166 with a significance value of 0.336. At this level, the regression coefficient is not significant because the value of $0.336 > 0.05$ thus it is declared that "H2: firm size affects auditor switching" is not supported by the data.

The results of the research described above show that the size of a company does not influence the company to conduct auditor switching that supports Aminah and Werdhaningtyas (2017). Wijaya and Rasmini (2015) also showed that company size influences auditor switching. Client companies with small total assets tend to move to KAPs that are not affiliated with the Big Four as auditors, whereas companies with large total assets choose KAPs affiliated with Big Four. In this research, the company has a small total assets and has used non-Big Four KAP and the company with a large portion of large assets has used the Big Four KAP so the tendency to do auditor switching does not occur.

In addition, Effendi and Rahayu (2015) stated that client size did not significantly influence auditor switching. When a company trusts the reputation of the KAP that has been auditing it, then the changes in the size of a company cannot be the basis for predicting company's auditor switching.

Effect of KAP Size on Auditor Switching

The third hypothesis of this study stated that the size of KAP has a significant influence on the occurrence of auditor switching in manufacturing companies listed on the Indonesia Stock Exchange in 2014 - 2017. The regression coefficient value obtained from the management change variable is -0.765 with a significance value of 0.238. At the level, the regression coefficient is not significant because the value $0.238 > 0.05$ so it is concluded that "H3: KAP size affects auditor switching" is not supported by the data.

The results of the research explained that the KAP size that audits a company has no influence on the occurrence of auditor switching. This is consistent with Kurniaty (2014) stating that companies that make KAP class changes from the Big Four are feared to trigger negative sentiments from market participants regarding the quality of financial reporting from the company concerned. Market participants, especially shareholders, will speculate or have certain prejudices that could jeopardize the company's reputation.

Conversely, companies that move to Big Four auditors will create a tendency to obtain unqualified audit opinions due to the auditor's consideration of better audit quality. The results of this study also support Pratini and Astika's (2013) research conducted in the 2008 - 2011 period and Wijaya and Rasmini (2015) in the 2008 - 2013 period which stated that the KAP size had no effect on auditor switching. The study also used a sample of 2014-2017 manufacturing issuers similar to those used in this study. According to Angraini in Wijaya and Rasmini (2015), it is stated that KAP size is not a factor that has a large contribution that encourages company managers to replace their auditors.

The Effect of Financial Distress on Auditor Switching

The fourth hypothesis of this study stated that financial distress has a significant influence on the occurrence of auditor switching. The regression coefficient value obtained from the management change variable is 0.072 with a significance value of 0.854. At the level, the regression coefficient is not significant because the value of $0.854 > 0.05$ so it is identified that "H4: Financial distress influences auditor switching" is not supported by the data.

The results of the study explain that financial distress is a factor that does not affect the occurrence of auditor switching. This is in line with the results of research by Faradila and Yahya (2016) and Kurniaty (2014). Companies that experience unhealthy financial conditions choose not to replace their auditors due to the possibility of high start-up costs. The unstable condition of the company makes the decision to conduct auditor switching risky. Companies will prefer to reduce costs by saving audit fees for new auditors when the previous auditor's audit period has ended.

In addition, companies experiencing financial distress will tend not to do auditor switching to maintain the trust of shareholders and creditors. Even if the company changes its auditor, the new auditor will still try to dig deeper information on actual condition of the company which results in the same company's financial condition.

Effect of Auditor Specialization on Auditor Switching

This fifth hypothesis of this study states that auditor specialization has a significant influence on the occurrence of auditor switching. The regression coefficient value obtained from the management change variable is 0.105 with a significance value of 0.822. The regression coefficient is not significant because the value $0.822 > 0.05$ so it is concluded that "H5: Specialization of auditors influences auditor switching" is not supported by the data.

The results of the study indicate that auditor specialization has no effect on the occurrence of auditor switching. The hypothesis made cannot be fulfilled because it is suspected that only a small portion of the total sample of companies collected uses specialist auditors as its auditors. Of the total 144 samples, only 38.89% used specialist auditors. The auditor's specialization might affect the audit quality of a company from a certain point of view, but it does not directly affect the management's decision to conduct auditor switching.

Based on the research that has been done, the researcher concludes a non-specialist auditor does not mean having lower quality than specialist auditors. Referring to the audit standard set by the Indonesian Institute of Certified Public Accountants which must be obeyed by all independent auditors regardless of whether the auditor is a specialist or non-specialist.

Conclusion

This study shows that there is no significant effect between management substitution, company size, KAP size, financial distress, auditor specialization on auditor switching. These independent variables only explain 2.7% of their influence on the dependent variable, namely auditor switching. Thus, other variables to test auditor switching such as profitability ratio, audit fee, audit delay, etc., can be implemented in the future studies.

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