

Do Leadership Shake-Ups and Financial Struggles Drive Auditor Changes?

Hubertus Ade Resha Raditya Boli^{1*}, Muhammad Azerifki Nuzul Akbar²

^{1,2} Fakultas Ekonomi dan Bisnis, Universitas Pelita Harapan, Indonesia

Abstract

This study investigates the influence of management turnover and financial distress on auditor changes. The research employs a purposive sampling method and utilizes secondary data, specifically financial statements and annual reports of companies listed on the Indonesia Stock Exchange from 2020 to 2023. The sample comprises 324 observations from 81 companies in the non-cyclical consumer goods sector. Logistic regression analysis is applied, as the dependent variable is a binary (dummy) variable. The results indicate that neither management turnover nor financial distress significantly affect auditor changes, suggesting that a company's decision to switch auditors is independent of changes in its board of directors or financial condition. The findings of this study highlight the complexity of auditor change decisions, suggesting that factors beyond management turnover and financial distress may play a more significant role. These results provide valuable insights for regulators, investors, and policymakers in understanding the stability of auditor-client relationships.

Keywords: Auditor Change, Financial Distress, Management Turnover.

Korespondensi:

Hubertus Ade Resha Raditya
Boli
(uph.hubertusade@gmail.com)

Submit: 25-03-2025

Revisi: 28-04-2025

Diterima: 17-05-2025

Terbit: 22-05-2025



1. Introduction

An audit is a systematic and structured process aimed at gathering and evaluating evidence related to an entity's economic activities and transactions, with the objective of determining whether the financial statements fairly represent its financial position (Zdravkoski et al., 2016). The outcome of the audit is communicated to stakeholders to support informed decision-making (Lessambo, 2018). A fundamental principle of auditing is auditor independence, which ensures objectivity, impartiality, and the absence of conflicts of interest in the evaluation process. To uphold this principle, companies typically appoint external auditors who are independent of management influence (Njagi, 2023). In practice, companies engage external auditors from Public Accounting Firms (KAP), selecting them based on various factors such as reputation, audit fees, and compliance with regulatory requirements on auditor rotation. Auditor rotation may occur under two conditions: mandatory or voluntary. Mandatory auditor rotation is governed by Government Regulation No. 20 of 2015 on Public Accountant Practices, Article 11, which limits a public accountant to auditing the same entity for a maximum of five consecutive years. Voluntary changes are initiated either by the auditor or the client. Auditor withdrawal, as outlined in ISA 705, typically occurs when the auditor identifies heightened audit risk, such as potential material misstatements. Conversely, auditor dismissal is a decision made by company management, often due to internal changes such as management turnover or financial distress.

A notable example of auditor change occurred in 2019 with PT Garuda Indonesia (Persero) Tbk. The company dismissed its auditor, KAP Tanubrata Sutanto Fahmi Bambang & Rekan, after the issuance of an unqualified opinion on its 2018 financial statements, which was later challenged by the Financial Services Authority (OJK) and the Supreme Audit Agency (BPK). Investigations revealed premature revenue recognition from a contract with Mahata Aero Teknologi, leading to a required restatement and the appointment of a new auditor, KAP Purwantono, Sungkoro & Surja (member of Ernst & Young). This case underscores the strategic and regulatory implications of auditor changes and their potential impact on investor confidence and corporate governance. Auditor changes, whether regulatory or discretionary, can signal underlying risks, including financial instability or governance issues. Excessive auditor turnover may disrupt audit continuity, compromise audit quality, and raise concerns among investors. Consequently, examining the relationship between financial distress, management turnover, and auditor changes offers valuable insights into corporate behaviour, regulatory compliance, and transparency.

Recent empirical studies have explored these dynamics with varying conclusions. Darmayanti et al. (2021) and Izza et al. (2022) found that management turnover positively correlates with auditor changes. Conversely,

Azlin & Taqwa (2023) reported no significant relationship. Regarding financial distress, Putri & Wulandari (2023) and Fenny et al. (2020) identified a positive association with auditor changes, while Darmayanti et al. (2021) and Wati (2020) revealed opposing results, suggesting that financial distress negatively impacts auditor turnover. This study distinguishes itself from previous research by focusing on the consumer goods sector, which remained relatively resilient during the COVID-19 pandemic and sustained investor interest in 2020. In contrast, earlier studies predominantly targeted manufacturing firms. To ensure robustness, this research incorporates firm-specific control variables, including firm size, firm age, Return on Assets (ROA), and leverage, factors that have received limited attention in prior literature. This study contributes to the auditing literature by providing sector-specific insights, clarifying conflicting empirical findings, and offering implications for regulatory bodies and investors concerned with audit quality and corporate governance.

Theoretical Framework and Hypothesis Development

Agency Theory

This study is anchored in agency theory, as proposed by Jensen & Meckling (1976), which analyzes the principal-agent relationship arising from a contractual delegation of authority. In corporate governance, principals (e.g., shareholders or owners) delegate decision-making responsibilities to agents (e.g., executives or managers), who are expected to act in the principals' best interests. However, this relationship is often challenged by information asymmetry since agents typically possess more comprehensive internal information than principals. This imbalance can lead to agency problems, including opportunistic behavior, inefficiencies, and potential financial misrepresentation (Elder & Zhou, 2002). To address these risks, auditors function as independent intermediaries, enhancing the reliability of financial reporting. By verifying financial statements, auditors reduce information asymmetry, promote transparency, and reinforce accountability. Their role is essential in upholding the integrity of corporate governance and ensuring informed decision-making by stakeholders.

The Impact of Management Turnover on Auditor Change

Management changes can occur at any time due to factors such as shareholder decisions or voluntary resignations (Winata & Anisykurlillah, 2018). New management often introduces revised strategies and policies to enhance organizational performance (Adli & Suryani, 2019). One such area of change may involve the selection of the Public Accounting Firm (KAP) responsible for auditing the company's financial statements. Dissatisfaction with prior audit outcomes may prompt early termination of auditor appointments, even before the standard five-year engagement period concludes (Wibowo & Rahmawati, 2019).

In this context, newly appointed management tends to select auditors whose practices align more closely with their strategic direction and governance approach. Auditor switching, therefore, can be a direct consequence of leadership transitions (Augustyvena & Wilopo, 2017). Empirical studies by Baskara & Hermi (2022) and Pebriani et al. (2022) support this view, finding a positive association between management turnover and auditor changes. Based on these considerations, the following hypothesis is proposed:

H1: Management changes have a positive influence on auditor switching.

The Impact of Financial Distress on Auditor Change

Financial distress is a condition in which a company is unable to meet part or all of its financial obligations, particularly short-term liabilities, often due to insufficient cash or bank balances (Darmayanti et al., 2021). According to Priambardi & Haryanto (2014), companies in financial distress frequently switch auditors, aiming to obtain a more objective assessment of their financial position. Such changes are expected to help mitigate further deterioration and reduce the likelihood of bankruptcy (Darmayanti, 2017). Empirical evidence from Putri & Wulandari (2023) and Fenny et al. (2020) supports a positive relationship between financial distress and auditor switching. Based on this, the following hypothesis is proposed:

H2: Financial distress has a positive effect on auditor switching.

2. Metode

This study examines companies listed on the Indonesia Stock Exchange (IDX), selected through purposive sampling. The sample includes publicly traded firms in the non-cyclical consumer goods sector that were listed between 2020 and 2023 and published audited financial statements during the same period. Data were obtained from company websites, the official IDX website, S&P Capital IQ, and other reputable sources. The analysis employs logistic regression using STATA 17, appropriate for a binary (dummy) dependent variable. This method is selected under the assumption that the data do not follow a normal distribution. The relationships among the variables are represented by the following equation:

$$AUCHANGE_{i,t} = \alpha_{i,t} + \beta_1 MNGTURN_{i,t} + \beta_2 FIN_{i,t} + \beta_3 SIZE_{i,t} + \beta_4 AGE_{i,t} + \beta_5 ROA_{i,t} + \beta_6 LEV_{i,t} + \beta_7 COV_{i,t} + e$$

Information:

α : Constant Coefficient
 β_1 - β_7 : Regression Coefficient
AUCHANGE : Auditor Change
MNGTURN : Management Turnover
FIN : Financial Distress
SIZE : Firm Size
AGE : Firm Age
ROA : Return on Asset
LEV : Leverage
COV : COVID-19 Pandemic
e : Residual Errors
i : Firm i
t : Year t

Table 1. Research Variables and the Measuremets

No	Variable	Proxy	Formula
1	Auditor Change (AUCHANGE)	Dummy Variable (Safriliana et al., 2020)	1: Auditor Change 0: No Auditor Change
2	Management Turnover (MNGTURN)	Dummy Variable (Adli & Suryani, 2019)	1: Management Turnover 0: No Management Turnover
3	Financial Distress (FIN)	Debt-to-Equity Ratio (DER) (Kurniasih & Surachim, 2018)	$\frac{\text{Total Debt}}{\text{Total Equity}}$
4	Firm Size (SIZE)	Natural Logarithm of Total Asset (Saraswati & Bernawati, 2020)	$\ln (\text{Total Asset})$
5	Firm Age (AGE)	Firm Age (Margaretha & Viriany, 2023)	Number of years since the company's establishment
6	Return on Asset (ROA)	Return on Asset (ROA) (Fangohoi et al., 2023)	$\frac{\text{Net Income}}{\text{Total Asset}}$
7	Leverage (LEV)	Debt-to-Asset Ratio (DAR) (Lumbantobing et al., 2020)	$\frac{\text{Total Debt}}{\text{Total Asset}}$
8	COVID-19 (COV)	Dummy Variable (Jannah & Khoirunurrofik, 2022)	1: Covid Year 0: Non-Covid Year

3. Results and Discussion

Descriptive Statistics

Table 2. Descriptive Statistics

Variable	Mean	Std Dev	Min	Max
AUCHANGE	0.091	0.288	0	1
MNGTURN	0.432	0.496	0	1
FIN	1.432	2.136	0.007	23.41625
SIZE	14.902	1.597	11.415	19.004
AGE	3.561	0.588	1.386	4.744
ROA	0.047	0.129	-0.255	0.920
LEV	2.485	2.313	1.006	24.416
COV	0.503	0.500	0	1

Source: Data Processed (2025)

Auditor Change (AUCHANGE), the dependent variable, is a binary indicator (1 = change in public accounting firm; 0 = no change), with a mean of 0.091 and a standard deviation of 0.288. The main independent variable, Management Turnover (MNGTURN), also binary (1 = change in board of directors), has a mean of 0.432 and a standard deviation of 0.496. Financial Distress (FIN) is measured using the Debt-to-Equity Ratio (DER), ranging from 0.007 to 23.416, with a mean of 0.432 and a standard deviation of 0.496. Firm Size (SIZE), calculated as the

natural logarithm of total assets, ranges from 11.485 to 19.004 (mean = 14.902; SD = 1.597), while Firm Age (AGE) spans 1.386 to 4.744 (mean = 3.561; SD = 0.588). Return on Assets (ROA), a control for profitability, ranges from -0.255 to 0.920 (mean = 0.047; SD = 2.313). Leverage (LEV), defined as total liabilities to equity, ranges from 1.006 to 24.416, with both mean and standard deviation at 2.313. COVID-19 (COVID) is a dummy variable (1 = pandemic period), with a mean of 0.503 and a standard deviation of 0.500.

Goodness-of-Fit Test

Table 3. Goodness-of-Fit Test Result

Logistic Model for AC, Goodness-of-Fit Test	
Number of Observations	324
Number of Covariate Patterns	312
Pearson chi2(304)	289.66
Prob > chi2	0.7136

Source: Data Processed (2025)

The p-value of 0.7136 in Table 3 exceeds the 0.05 significance level, indicating no statistically significant discrepancy between the model and the observed data. Thus, the logistic regression model demonstrates a good overall fit.

Log likelihood

Table 4. Log Likelihood Result

Iteration	Value
Iteration 0: log likelihood	-96.987665
Iteration 1: log likelihood	-85.962121
Iteration 2: log likelihood	-83.755776
Iteration 3: log likelihood	-83.742460
Iteration 4: log likelihood	-83.742448
Iteration 5: log likelihood	-83.742448

Source: Data Processed (2025)

Table 4 shows an increase in log-likelihood from -96.99 at iteration 0 to -83.74 at iteration 5, indicating improved model convergence and a better fit to the observed data.

Coefficient of Determination (Pseudo R-squared)

Table 5. Pseudo R-squared Result

Logistic Regression	
Number of Observation	324
Pseudo R2	0.1366

Source: Data Processed (2025)

The Pseudo R² value presented in Table 5 is 0.1366, or 13.66%. This indicates that the independent variables in the study account for 13.66% of the variance in the dependent variable, with the remaining 86.34% of the variation attributable to factors not included in the analysis.

LR Chi2 Statistics

Table 6. LR Chi2 Statistics

Logistic Regression	
Number of Observation	324
LR Chi2(7)	26.49

Source: Data Processed (2025)

The results from the model adequacy test, as shown in Table 6, yield an LR Chi2 statistic of 26.49. These findings indicate that, at the 10% significance level ($\alpha = 0.10$), none of the independent variables exhibit a statistically significant effect on the dependent variable.

Hypothesis Test

Table 7. Hypothesis Test Result

AUCHANGE	Coef.	P> z	Sig
MNGTURN	0.518	0.266	
FIN	0.066	0.879	
SIZE	-0.350	0.004	***
AGE	-0.593	0.082	**
ROA	-3.611	0.053	**
LEV	-0.065	0.877	
COV	0.773	0.057	**

*** p<.01, ** p<.05, * p<.1

Source: Data Processed (2025)

The results from the hypothesis testing, as presented in Table 7, indicate that the MNGTURN variable has a coefficient of 0.518 and a p-value of 0.266. This suggests that MNGTURN does not have a statistically significant effect on the AUCHANGE variable. Likewise, the FIN variable, with a coefficient of 0.066 and a p-value of 0.879, also shows no significant impact on AUCHANGE. Both variables exhibit significance levels that exceed the 10% threshold ($\alpha = 10\%$), confirming the lack of a statistically meaningful relationship. Consequently, Hypothesis 1 and Hypothesis 2 are not supported by empirical evidence in this study.

Management Turnover does not affect Auditor Change

This study finds that changes in a company's board of directors, particularly within firms in the non-cyclical consumer goods sector listed on the IDX, do not necessarily lead to dissatisfaction with the audit outcomes delivered by the previous auditor. Although some firms did replace their public accounting firm following board changes, the new management often continued to rely on the former auditor. This suggests that the incoming management's policies and expectations were generally aligned with those of the previous auditor.

These findings are consistent with Azlin & Taqwa (2023), who argue that auditor continuity despite management turnover indicates strategic alignment between the two parties, reducing the impetus for auditor switching. Similarly, Reschiwati & Syifa (2023) highlight that if the KAP maintains its professional conduct and independence, a change in management, even in cases of audit opinion misalignment, does not necessarily disrupt the client-auditor relationship.

Financial Distress does not affect Auditor Change

This study found no significant evidence that financial distress influences auditor switching. A likely explanation is the increased cost associated with appointing a new auditor, particularly during the transition period when the incoming audit firm must invest time and resources to understand and adapt to the client's business operations. Given the financial strain, companies are generally reluctant to incur additional expenses that could further destabilize their condition.

These findings align with prior research by Berliana et al (2023) and Tjahjono & Khairunissa (2021), which suggest that auditor changes, especially those occurring outside regulatory timeframes, may raise concerns among shareholders and investors. In financially distressed situations, firms often intensify scrutiny over auditor subjectivity to preserve stakeholder trust and avoid triggering negative market reactions.

4. Conclusion

The empirical findings of this research indicate that neither management turnover nor financial distress significantly influences the likelihood of switching auditors. The absence of a significant relationship suggests that new management may opt to retain existing auditors, potentially due to trust in their competence, independence, and familiarity with the company. Similarly, financially distressed firms may avoid auditor changes to minimize additional costs and disruptions during unstable periods.

These insights underscore that, management transitions and financial challenges are not primary drivers of auditor replacement. For companies, maintaining continuity in audit relationships may offer stability and cost efficiency. Auditors can focus on fostering long-term client relationships, while regulators may view the observed auditor retention as an indicator of market resilience. However, continued oversight of audit independence and transparency remains critical.

Limitations of this study include its narrow sectoral scope, focusing exclusively on non-cyclical consumer goods firms, and the use of limited proxies for management turnover and financial distress. Future research should broaden the sample to include multiple sectors and adopt a more diverse set of explanatory variables to enhance the generalizability and depth of findings regarding auditor change determinants.

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