

The Effect of Financial Distress, Audit Opinion and Management Change on Auditor Switching

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ABSTRACT

The purpose of this research is to provide empirical data on the effects of audit opinion, management change, and financial hardship on auditor switching in companies operating in the basic and chemical industrial sectors that are listed on the Indonesia Stock Exchange (IDX) between 2018 and 2023. Purposive sampling was used in this research, and a total of 70 organisations that fit the preset sample criteria were chosen. Panel data regression analysis was used in this research for data analysis, while E-Views 12 was used for data processing. The study's conclusions indicate that although financial crises and management changes have little effect on auditor switching, audit opinion has a negative impact on it.

INTRODUCTION

The fastest-growing industries are the basic and chemical industries, which supply almost all of our daily needs. These include the ceramics, glass, and porcelain subsectors; Feed; Chemicals; metal; as well as plastics and packaging. Due to its rumored ability to generate huge profits, the industry attracts the interest of potential investors. As a general rule, companies must provide audited financial statements annually (KAP). The main position of the company is held by a public accountant, known as an auditor. The auditor is obliged to determine with sufficient certainty whether there are substantial misstatements in the financial statements that may have been caused by fraud or error, as stated in (SA) 240 No. 5. Because they are not required to take a position, show partiality, or be influenced in any way, Independent Auditors are essential in auditing financial statements. However, due to the existence of excessively long employment contracts, we often see cases where clients and auditors work together. Therefore, auditor replacement is a necessary procedure for companies to ensure the integrity of their financial statements and the independence of their auditors.

The replacement of auditors in Indonesia is based on Article 16 Paragraph 1 of OJK Regulation of the Republic of Indonesia Number 13/POJK.03/2017 concerning the Use of Republic Accountant Services and Public Accounting Firms in Financial Services Activities "Parties carrying out financial services are obliged to limit the use of audit services for annual historical financial information from the same AP for a maximum audit period of 3 (three) consecutive reporting book years".

Companies listed on the Indonesia Stock Exchange (IDX) in the mining sector show a worrying trend of auditor turnover. In 2015, there were 32 companies that replaced auditors, then increased to 40 companies in 2016 and remained 40 companies in 2017. Especially in 2015, eleven companies changed auditors, but this number decreased to five companies in 2016, and increased again to eight companies in 2017. In addition, in 2015 there were ten companies, eight companies in 2016, and five companies in 2017 that did not submit audited financial statements. The long-term relationship between auditors and clients can threaten the independence of auditors in evaluating audit data objectively (IDX data has been analyzed since 2019).

LITERATURE REVIEW

Agency Theory

According to (Jensen & Meckling, 1976), "the emergence of agency relationships is when one or more principal persons hire another person (agent) to provide services and then delegate decision-making authority to that agency". Agency relationships are formed through contracts between shareholders and

management. Shareholders entrust responsibility to the management to act as an agent for the company.

Companies that have a division between management and ownership functions may face challenges due to conflicts of interest and information imbalances, which can lead to agency conflicts. Managers often prioritize their personal interests, which can create conflict within the organization. In such cases, it becomes important to seek advice from a public accountant who can independently evaluate the financial accountability of management and provide an unbiased opinion on the fairness of financial statements (Mahantara, 2013).

The principal must have confidence in the agent's performance based on the audited financial statements. To pursue its own interests, agents use the services of public accountants. The agent would be better off replacing the auditor than risking losing the principal if the agent believes that the previous auditor did not act in the best interests of the agent and has betrayed the principal's trust (Aminah et al., 2017). In agency theory, auditor turnover refers to the practice of using an impartial third party, i.e., an auditor, to provide an opinion on the reliability of financial statements and mediate disputes between principals and agents. Agency fees can result from agent egoism, but auditors can help mitigate this problem (Juriati et al., 2019).

Auditor Switching is a change of auditor or public accounting firm carried out by a company. Companies have the option of replacing auditors voluntarily or not. Mandatory auditor switching can occur due to government regulations that require the Company to replace the KAP and its auditors. On the other hand, when a company changes a public accounting firm without going past the government-mandated assignment period, this is known as voluntary replacement of auditors. The absence of rules restricting companies from replacing before that period, auditor resignation, or the client's choice to fire the auditor are some of the potential causes of replacement of KAP and auditors (Adelany & Siagian, 2022).

Financial distress refers to the challenging financial situation that a company may face, often stemming from problems, crises, or financial instability, which could potentially lead to bankruptcy (Nurachma and Hakim, 2021). Companies facing financial challenges often choose to stick with their current auditors rather than switch to a new public accounting firm. When the financial situation changes for the worse, bringing in a new auditor may lead to additional costs during the initial assignment, and replacing the auditor may add pressure to the Company's finances. According to research conducted by (Herawaty & Ovami, 2021), found that the variable financial distress has a good impact on switching auditors, which means that if a company experiences financial distress, it tends

to switch auditors. However, research conducted by (Ngulya and Nurcahya, 2023) revealed that the variable financial distress has a negative impact on auditor turnover. Meanwhile, (Hestyaningsih, 2020) did not find a correlation between the two.

An independent auditor's assessment of whether a company's performance report is fair or not, and its conformity with the SAK is known as an audit opinion (Anggraeni et al., 2022). The opinion column in the audit report is where opinions are expressed. The purpose of the audit is based on the professional standards of independent auditors that the financial statements aim to provide an opinion on the fairness of all material matters, financial conditions, business results, changes in equity, and cash flows in accordance with generally accepted standards. Research by (Sinaga, 2021), shows that audit opinions have a positive effect on auditor turnover, this is because companies do not like auditors who provide opinions other than reasonable opinions without exception. while (Ramadan, et al., 2022) stated the opposite, This is due to the management's recognition that auditors working at KAP are professional and independent parties responsible for auditing and assessing the fairness of the company's financial statements in accordance with applicable provisions and regulations. And (Ramadhan et al., 2020) did not find a significant influence.

When a company's management structure changes, it is called a management change. Among these changes is the new composition of commissioners and directors. The change in the composition of the board of directors and commissioners is a general result of the resolution of the General Meeting of Shareholders (GMS). The company's policies may change whenever there is a change in management. The potential shift in the role of the board of directors may lead to a change in auditors (Liliana et al., 2024). According to research (Hestyaningsih, 2020) management change has a positive effect on auditor switching, this shows that management change tends to be followed by the adoption of new KAP. However (Ramadan et al., 2020) shows the opposite. (Labibah et al., 2023) also found that auditors are not affected by management changes.

The formulation of the problem in this study is as follows:

1. Does financial distress affect *auditor switching*?
2. Does audit opinion affect switching *auditors*?
3. Does the change of management affect the *switching auditor*?

METHODOLOGY

The research method is based on the selection between the data that actually occurs in the object and the data that can be obtained, so that the validity of the data in the research is highly dependent on the research technique (Sugiyono, 2017). The purpose of this study is to establish a causal relationship between

independent variables (financial distress, audit opinion, and management change) by using descriptive statistics with a causal quantitative methodology. E-Views 12, a statistical program, is used to conduct a quantitative causality approach.

Table 1. Operational Definition and Measurement of Variables

No.	Variable	Definition	Formula	Scale
1	Auditor Transfer (Y)	Auditor switching is the process by which a company changes the auditor or Public Accounting Firm it uses, which can be triggered by various factors both from the client side and the auditor itself. (Salim & Rahayu, 2014)	Auditor turnover = 1 No auditor turnover = 0	Nominal
2	Financial distress (X ₁)	The decline in a company's financial performance is caused by excessive spending, illiquid asset ownership, improper financial planning, and threats to revenue, resulting in continuous losses and inefficient cash flow management. (Nainggolan, et al., 2022)	$DER = \frac{\text{Total Liability}}{\text{Total Equity}} \times 100\%$	Ratio
3	Audit Opinion (X ₂)	An audit opinion is an evaluation or assessment by the auditor of the fairness of the financial statements of an audited entity. (Widajantie & Dewi, 2020)	Reasonable Opinion Without Exception = 1 Except for a reasonable opinion No exceptions = 0	Nominal
4	Management Change (X ₃)	Changes in management are usually determined at a general meeting of	Management change = 1 No management turnover = 0	Nominal

		shareholders or carried out by management who resigns of their own volition. This requires shareholders to appoint new management, such as a president director or CEO (Salim & Rahayu, 2014)		
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Source : from various literature, 2024

Population and Sample

Companies in the basic and chemical industries listed on the IDX are the companies that are the population in this study. Data recorded on the Indonesia Stock Exchange (IDX) is 80 companies from the chemical and basic (www.idx.co.id) industries. Companies listed on the Indonesia Stock Exchange in the Basic and Chemical Industries provided the data used in this study. Sampling is based on certain criteria, namely by *purposive sampling technique*:

1. Companies in the Basic Industry and Chemical sectors listed on the Indonesia Stock Exchange for the period 2018 - 2023.
2. Companies in the Basic Industry and Chemical sectors that do not publish their annual reports for 2018 - 2023.

Data Analysis Techniques

This study uses quantitative analysis as an analytical approach. This method quantifies the data of the research sample to produce the data needed for the data analysis procedure. Statistics for descriptions, panel data selection methods for regression (including chow, hausman, and langrange multiplier tests), R2 (coefficient of determination), simultaneous hypothesis testing, and so on.

1) Descriptive Statistical Analysis

One way to describe an event with the aim of gathering relevant fundamental data is descriptive statistical analysis. Before using a descriptive analysis approach to test a hypothesis, descriptive statistics are typically used to determine the sample data profile.

2) Panel Data Regression Estimation

The following are three methods for estimating the regression of panel data listed by Ghozali et al. (2013):

a. Common Effects Model (CEM)

By integrating time series and cross-sectional data without considering time or entity variations, *the Common Effect Model* provides an easy method to calculate

panel data model parameters. *The Ordinary Least Square (OLS) method* is used as an estimation strategy in this approach.

b. *Fixed Effect Model (FEM)*

The Fixed Effect Model is a model whose intercept is different for each entity but remains constant over time. As an estimation methodology, the *Ordinary Least Square (OLS) method* is the method used.

c. *Random Effects Model (REM)*

This technique will estimate panel data using the *Random Effects Model*, which allows for the possibility of perturbation variable associations (*error terms*) among people (entities) over time (Agus, 2015:359). An estimation technique known as *Generalised Least Square (GLS)* is used in this approach.

3) Selection of Panel Data Regression Model Techniques

a. *Chow Test*

In Ghazali and Ratmono (2013:269) When deciding on *the fixed effect model (FEM)* and *the common effect model (CEM)*, researchers often use the chow test. The following are the basis for making a decision:

1. *The Common Effect Model (CEM)* is the best model to apply if the probability of the F cross-section is greater than a significant value of 0.05, which means that H₀ is accepted.
2. *The Fixed Effects Model (FEM)* is the best model to use if the probability of *crossing the F section* is less than a significant value of 0.05, which means that H₀ is rejected.

b. *Hausman Test*

If you want to find out whether a model is a *Fixed Effect Model (FEM)* or a *Random Effect Model (REM)*, you can use the Hausman test (Ghazali and Ratmono, 2013). The results of this test will show whether the *Fixed Effect Model* or the *Random Effect Model (REM)* is superior.

The following is the basis for his decision-making:

1. H₀ is accepted, and *the Random Effect Model (REM)* is a suitable model to use, if the probability value for the random cross-section > 0.05 significant value.
2. *Fixed Effect Random (FEM)* is the best model to use if the probability value for the random cross-section is less than 0.05, indicating that H₀ is rejected.

c. *Lagrange Multiplier Test*

In estimating panel data, *the Lagrange multiplier test* can help determine whether the *Random Effect Model (REM)* or *Common Effect Model (CEM)* is more appropriate to use (Gujarati and Porter, 2012). To test the significance using the residual values of the OLS approach,

Breusch-Pagan created the *Random Effect Model* (REM). Gujarati and Porter (2012) state that the following are the basis for decision-making:

1. A suitable model for use is the *Common Effect Model* (CEM) if the Breusch-Pagan cross-sectional value > 0.05 , which indicates that H_0 is accepted.
 2. Since H_0 is rejected if the *Breusch-Pagan cross-sectional value is less than 0.05*, the *Random Effect Model* (REM) is the right model to use in this case.
- 4) Determination Coefficient Test (R^2)
- The determination coefficient test is used to assess the extent to which the model can explain the variability of dependent variables, as stated by Ghozali and Imam (2016). Independent variables can only provide a limited explanation for the change of the dependent variable if the resulting R^2 value is small.
- 5) Model Feasibility Test (Test F)
- If the regression model can predict the influence of independent and dependent variables simultaneously, then the F test can be performed. To find out whether the independent variables together do not have a significant effect on the dependent variables, the F test uses the following criteria:
- a) If the probability value > 0.05 , then H_0 is accepted and H_a is rejected.
 - b) The null hypothesis (H_0) is rejected and the alternative hypothesis (H_a) is accepted if the probability value < 0.05 . This shows that the independent variable has a substantial and simultaneous influence on the dependent variable.
- 6) Hypothesis Test (T-Test)
- According to Ghozali and Imam (2016), the t-test can be used to determine the influence of independent variables on dependent variables individually (partially). The decision-making policy is as follows:
- a) The null hypothesis (H_0) is rejected if the probability value is less than 0.05 and the calculated t-value is greater than the t-table. This implies that dependent variables can be considered.
 - b) H_0 is accepted if the calculated t-value is less than the t-table and the probability value is greater than 0.05. Dependent variables are not affected by independent variables.

RESEARCH RESULTS

Descriptive Statistics Test Results

Table 2. Descriptive statistics results

	X1	X2	X3	Y
Mean	4.142617	0.995238	0.404762	0.211905
Median	0.807212	1.000000	0.000000	0.000000
Maximum	786.9311	1.000000	1.000000	1.000000
Minimum	-7.731656	0.000000	0.000000	0.000000
Std. Dev.	40.93699	0.068924	0.491431	0.409145
Skewness	17.30706	-14.38766	0.388057	1.409959
Kurtosis	322.8862	208.0048	1.150588	2.987983
Jarque-Bera	1811693.	749962.2	70.39684	139.1614
Probability	0.000000	0.000000	0.000000	0.000000
Sum	1739.899	418.0000	170.0000	89.00000
Sum Sq. Dev.	702175.7	1.990476	101.1905	70.14048
Observations	420	420	420	420

Source : Processed data from E-views 12, 2024

There are a total of 420 observations or samples used in this investigation, as shown in the table above. Information was obtained from seventy-one sample companies during a six-year tracking period (2018-2023).

1. The Y variable, which is the "Auditor Switching," gets a value between 0.0000000 and 1.000000. Switching Auditor has an average value of 0.211905 and a standard deviation of 0.409145.
2. The X₁ variable (*Financial distress*) has a minimum value of -7.731656 and a maximum value of 786.9311. The average value of the X₁ variable (*Financial distress*) during the observation period was 4.142617 with a standard deviation of 40.93699.
3. The value range for the X₂ (Audit Opinion) variable is from 0.000000 to 1.000000. During the study, the X₂ variable (Audit Opinion) had an average value of 0.995238 and a standard deviation of 0.068924.
4. The value range for the X₃ variable (Management Change) is from 0.000000 to 1.000000. During the study, the X₃ variable (Management Change) had an average value of 0.404762 and a spread of 0.491431.

Chow Test Results

Table 3 Chow Test Result

Redundant Fixed Effects Tests			
Equation: Untitled			
Test cross-section fixed effects			
Effects Test	Statistic	d.f.	Prob.
Cross-section F	2.106578	(69,347)	0.0000
Cross-section Chi-square	146.946631	69	0.0000

The probability value of the cross-section of F $0.0000 < \alpha (0.05)$ is displayed. Therefore, it can be said that this model uses a *Fixed Effect Model* (FEM) which is more suitable than *the Common Effect Model* (CEM).

Hausman Test Results

Table 4 Hausman Test Result

Correlated Random Effects - Hausman Test
Equation: Untitled
Test cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	5.277499	3	0.1526

The random cross-sectional probability value of $0.1526 > \alpha (0.05)$ is shown in the table above. This indicates that *the Random Effect Model (REM)* should be used, not *the Fixed Effect Model (FEM)*.

Lagrange Multiplier Test Results

Table 5 Lagrange Multiplier Test Result

Lagrange Multiplier Tests for Random Effects
Null hypotheses: No effects
Alternative hypotheses: Two-sided (Breusch-Pagan) and one-sided (all others) alternatives

	Test Hypothesis		
	Cross section	Time	Both
Breusch-Pagan	23.29053 (0.0000)	1.260784 (0.2615)	24.55132 (0.0000)
Honda	4.826027 (0.0000)	-1.122846 (0.8692)	2.618544 (0.0044)
King-Wu	4.826027 (0.0000)	-1.122846 (0.8692)	0.170217 (0.4324)
Standardized Honda	4.949462 (0.0000)	-0.913767 (0.8196)	-3.150728 (0.9992)
Standardized King-Wu	4.949462 (0.0000)	-0.913767 (0.8196)	-3.195515 (0.9993)
Goufieroux, et al.	--	--	23.29053 (0.0000)

The cross-sectional value of Breusch-Pagan is $0.0000 < \alpha (0.05)$. Thus, it can be concluded that it is better to apply *the Random Effect Model (REM)* than *the Common Effect Model (CEM)*.

Model Conclusion

Table 6. Model Conclusion

Method	Testing	Results
Chow Test	CEM vs FEM	FEM
Hausman Test	FEM vs REM	REM
Lagrange Multiplier Test	CEM vs REM	REM

Source : E-views Data 12, 2024

The Random Effect Model (REM) is the Panel Data Regression Model that will be used for hypothesis testing, based on the three tests that have been used as shown in the table above.

Coefficient of Determination and F (Model Feasibility) Test Results

Table 7. Coefficient of Determination and F (Model Feasibility) Test Results

Weighted Statistics			
R-squared	0.020669	Means it depends on var	0.147737
R-squared adjusted	0.013606	S.D. depends on var	0.375853
S.E. regression	0.373287	Number of squares of the resid	57.96672
F-stats	2.926521	Durbin-Watson Statistics	2.017645
Prob (F-stats)	0.033578		

Source : Data processed with E-views 12, 2024

The R-squared value is just under 2%, or 2.0669%. Financial difficulties, audit opinions, and management turnover accounted for 2.066% of the auditor turnover variance in the Basic and Chemical Industries in Indonesia, according to the value of the determination coefficient. Other variables that were not taken into account in this study accounted for the remaining 97.934%. It can be concluded that the Independent Variable (X) has an effect on Switching Auditors in the Basic and Chemical Industry sector because the F-Statistical value of 2.926521 > the F table is 2.626352 and the probability value (F-Statistics) is 0.033578 < 0.05 minus H_0 and accepts H_a .

Uji t (Partial Test) Analysis Test Results and Discussions

Table 8. uji t (partial test) Analysis Test Results

Dependent Variable: Y
 Method: Panel EGLS (Cross-section random effects)
 Date: 05/14/24 Time: 21:36
 Sample: 2018 2023
 Periods included: 6
 Cross-sections included: 70
 Total panel (balanced) observations: 420
 Swamy and Arora estimator of component variances

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.879557	0.276438	3.181753	0.0016
X1	0.000347	0.000465	0.746735	0.4556
X2	-0.894605	0.275899	-2.519437	0.0121
X3	0.054865	0.040032	1.370523	0.1713

Source : Data processed with E-views 12, 2024

The findings of the t-test (partial test) can be understood from the following table:

1. The results of the T test on the financial distress variable (X_1) were obtained

as $0.746735 < 1.965655$ and the sig. value was $0.4556 > 0.05$ Then H_1 was rejected, meaning that *the financial distress* variable had no effect on the *switching of auditors* in companies in the Basic Industry and Chemical sectors.

2. The results of the T test on the audit opinion variable (X_2) obtained t were calculated as $2.519437 > 1.965655$ and the value of sig. $0.0121 < 0.05$, then H_2 was accepted, meaning that the audit opinion variable had a negative effect on *the switching of auditors* in companies in the Basic Industry and Chemical sectors.
3. The results of the T test on the variable of management change (X_3) were obtained as $1.370523 < 1.965655$ and the value of sig. $0.1713 > 0.05$, then H_3 was rejected, meaning that this variable had no effect on *the switching of auditors* in companies in the Basic Industry and Chemical sectors.

Panel Data Regression Equation after T Test

$$Y = 0.879557116106 + 0.000347169909233 * X_1 - 0.694605487867 * X_2 + 0.0548650851641 * X_3 + [CX=R]$$

The explanation is as follows:

1. The value of the constant 0.879557116106 can be interpreted that if the independent variable increases by an average of one unit, then the dependent variable will also increase by 0.879557116106.
2. The value of the Regression Coefficient of the X_1 financial *distress* variable is (+) of 0.000347169909233, so it can be interpreted that if the X_1 variable increases, then the *switching variable Auditor Y* also increases by 0.000347169909233, and vice versa.
3. The value of the regression coefficient of the X_2 variable of the audit opinion is (-) of 0.694605487867, so it can be interpreted that if the X_2 variable increases, then the switching auditor variable Y will decrease by 0.694605487867, and vice versa.
4. The regression coefficient value of variable X_3 of management change is (+) of 0.0548650851641, so it can be interpreted that if variable X_3 increases, then variable Y auditor *switching* also increases by 0.0548650851641, and vice versa.

DISCUSSION

1. The results of the T test for the Financial distress variable (X_1) produced a calculated t-value of 0.746735 which was smaller than the critical value of 1.965655. In addition, the significance value of 0.4556 is greater than the significance level of 0.05. Therefore, we reject the alternative hypothesis (H_1) which shows that *the variable of financial distress* does not have a significant effect on *switching auditors* in companies in the Basic Industry and Chemical sectors. The findings of this study are in line with previous research (Hestyaningsih, 2020), which states that companies that experience *financial difficulties* often avoid changing auditors. This is

because these companies prefer to minimize the costs associated with new audit assignments, such as the cost of familiarizing a new KAP with the company's industry. Thus, they aim to reduce the financial pressures and challenges they are currently facing.

2. The results of the T test for the audit opinion variable (X_2) produced a calculated t of 2.519437 which was greater than the critical value of 1.965665, and a significance value of 0.0121 which was smaller than 0.05. Therefore, we can accept H_2 , which shows that the variable of audit opinion has a negative effect on *auditor switching* in the Basic Industry and Chemical sectors. The findings of this study are consistent with research conducted by (Ramadan, et, al., 2022). According to him, audit opinions have a negative effect on the switching auditor, because management realizes that external auditors working in the company are professional and independent parties entrusted with examining and evaluating the accuracy of financial statements in accordance with relevant regulations and legislation.
3. The results of the T test for the management change variable (X_3) produced a calculated t-value of 1.370523, which was smaller than the critical value of 1.965655. In addition, the significance value of 0.1713 is greater than the threshold of 0.05. Therefore, we reject H_3 which indicates that this variable has no effect on *auditor switching* in companies in the Basic Industry and Chemical sectors. The findings of this study are in line with previous research (Ramadan, et, al., 2020). The results of the study show that when a company undergoes a change in management, there is often no change in policy. In particular, the study highlights that companies are more likely to retain their public accounting firms if they are satisfied with the performance of external auditors and if they match management expectations.

CONCLUSIONS AND RECOMMENDATIONS

1. *Financial distress* has no effect on *auditor switching* in the Basic Industry and Chemical sectors listed on the Indonesia Stock Exchange in 2018 – 2023.
2. Audit opinions have a negative effect on switching auditors in the Basic Industry and Chemical sectors listed on the Indonesia Stock Exchange in 2018 – 2023.
3. The change of management has no effect on *the switching* auditors in the Basic Industry and Chemical sectors listed on the Indonesia Stock Exchange in 2018 – 2023.

Researchers suggest developing research by adding company size, auditor tenure, and audit quality variables. And researchers suggest conducting deeper interviews with company management, auditors and other related parties can provide a deeper understanding of the reasons behind the auditor switching decision. As well as conducting case studies on companies that

experience auditor switching can provide a more detailed description of the factors that influence these decisions.

ADVANCED RESEARCH

In the process of conducting this research, there are limitations that may affect the results of the study, namely:

1. Limitations on research time, energy, and researcher's ability.
2. Researchers only use company samples in the basic and chemical industry sectors. So that the research results do not apply to all types of companies.
3. the theory used in the study may not be fully able to explain the phenomenon of auditor switching, so the results of the study may not be consistent with the existing theory.
4. The conclusions drawn are only based on the acquisition of data analysis, so it is hoped that further research on financial distress, audit opinion and management changes on auditor switching with different research methods, a wider sample, and the use of different and more complete research instruments.

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