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Indications of The Auditor Resignation from The Affecting Factors

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ABSTRACT

Purpose: This study aims to find empirical evidence on the impact of CEO (Chief Executive Officer) changes, financial performance, and audit fees on indications of auditor resignation. **Theoretical framework**: Agency theory is based on the contractual relationship between investors (principals) and managers (agents). The theory also explains that the relationship between the two parties is difficult to create due to a conflict of interest (Scott & O'Brien, 2019). The upper echelons theory considers top management as the primary strategic decision-maker in the organization. Thus, strategic decisions made by leaders have a direct impact on organizational outcomes. Because executives have responsibility for the organization as a whole, their characteristics, what they do, and how they do it, in particular, affect organizational outcomes. (Carpenter et al., 2004; Hambrick, 2007). Changes in auditors outside the applicable rules can occur for two reasons: the client decides to dismiss the auditor or the auditor departure from the client (Tanyi et al., 2010). Companies that change auditors show misunderstandings between auditors and managers regarding accounting or auditing matters. When the relationship between the auditor and his client is damaged, the auditor may decide to leave the job or vice versa, and the auditor is fired by the client (Lindrianasari, 2013). Financial performance can be analyzed using many measurements, but in this study, the financial performance measurement uses the ratio of return on assets. Nugroho (2015) said that profitability shows the company's success in generating profits. The audit fee is the number of fees incurred by the external auditor service user, so the amount of the fee that is income for the KAP depends on how complex and comprehensive the audit scope is and the reputation of the KAP in the community, government, and investors. (Hay & Davis, 2004). **Methods**: A logistic regression model was used to analyze the data. The sample was determined using a purposive sampling technique from the financial reports and reports of independent auditors of financial sector companies listed on the Indonesia Stock Exchange (IDX) for the 2011–2020 period and processed with the help of the SPSS application. **Findings**: The study results show that CEO turnover and financial performance affect auditor resignation, while audit fees have no effect. The samples tested in this study were taken from the annual reports of financial sector companies only, so the results of this study cannot be generalized to all types of industries. The observation period is also a limitation of the study, and different results may appear when the observation period is extended. **Originality/value**: The value of the study is expected to provide an understanding of the development of accounting studies related to auditor resignation and the factors that influence it.

Keywords: CEO turnover, company performance, audit fees, auditor resignation

1. INTRODUCTION

An auditor needs public trust in carrying out his duties, especially in providing audit services to his clients. Users of financial statements consider the auditor as an independent party who has sufficient experience and good accountability. This has an impact on user perceptions of the quality of audit services (Salehi et al., 2017). Auditors are very important parties, investors give trust and rely on audit reports and financial information evidenced by auditors to make investment decisions. Therefore, auditor resignation has a negative impact on the entire stakeholder community including shareholders and investors (Papdiwal, 2021). In his research, Papdiwal (2021) stated that the reasons that led to the resignation of the auditor were the lack of adequate information, the lack of cooperation with the management, and the conflict between the auditor and the client.

Research conducted in various countries on the factors that encourage the change of auditors has been tested. Auditor change occurs when companies terminate their auditors or when the auditor resigns from the engagement. Dismissal involves a company-initiated change of auditor, while resignation is initiated by the auditor (Schneider, 2015). Research by Boone & Raman (2001) regarding auditor change shows that information asymmetry increases more in companies whose auditors resign. The auditor's resignation may be related to unfavorable events within the client, among others, the auditor suspects management of fraud (financial statement manipulation), the client has weak internal controls, or the client's financial health is deteriorating (Boone & Raman, 2001). Other factors include high litigation risk, changes in fee structure, client's financial condition, modified audit opinion, corporate governance issues, and client disputes (Stefaniak, 2009). Auditor resignation has a more serious effect on market participants than dismissal (Turner, 2001). Market participants respond to news about auditor changes, these announcements are usually associated with a negative reaction to market prices (Griffin & Lont, 2010).

Clients who have a high risk of material misstatement may allow the auditor to consider withdrawing from the engagement. When a client's risk of material misstatement is high, the auditor usually expends more audit effort to reduce audit risk to an acceptable level, this results in an increase in audit fees. Griffin & Lont (2011) found evidence that auditor resignation was related to audit fees. Auditors will usually increase the audit fee due to the additional risks and liabilities, otherwise there will be resignation.

This research is motivated by two reasons. First, the issue of auditor turnover has implications for the credibility of financial reporting (Chang et al., 2019; Griffin & Lont, 2011b; H. H. Huang & Chan, 2018; Schneider et al., 2014). Although academics and practitioners have studied auditor change extensively in Indonesia, some research results are inconsistent. This condition causes academics to not get strong results related to the factors that influence auditor change. Second, so far the company has not submitted in writing the reasons for the change of auditors in the annual report. In addition, the reasons for changing auditors are often not communicated to stakeholders. The company tries to hide the facts behind the auditor change process because it will reveal the company's real problems (Y. Huang & Scholz, 2012; Nazri et al., 2012). This is an interesting phenomenon to study. Therefore, the factors that cause voluntary auditor change and the consequences of this change are still interesting to study.

Practically, the results of this study are expected to provide empirical evidence about the factors that can cause auditor change outside the applicable regulations, especially regarding auditor resignation. These results can be taken into consideration and a signal for investors who want to invest in companies that change auditors voluntarily, so that they are more careful. Specifically, the empirical evidence of this research is expected to provide input to the government to more intensively carry out monitoring and supervision for companies that change their auditors outside of existing regulations. This research is also expected to provide input for regulators in making policies and regulations, especially related to auditor resignation.

2. Literature review and hypothesis development

2.1 Agency Theory

In the accounting literature, the separation between owners and management is called agency theory. This is one of the theories in accounting development research that involves modifying the structure of the financial accounting model in which there is a behavioral aspect. Agency theory is based on the contractual relationship between investors (principals) and managers (agents). The theory also explains that the relationship between the two parties is basically difficult to create as a result of a conflict of interest (Scott & O'Brien, 2019). Agency relationships arise when one or more principals (owners) engage other people as agents to perform services on their behalf (Watts & Zimmerman, 1983). The theory of auditor change and choice is based on agency theory (Beattie & Fearnley, 1998). Agency theory to be a useful economic theory for accountability, which helps explain auditor change.

Jensen & Meckling (1976) describe the audit function as a process within the company that serves to identify the interests of managers with the interests of shareholders. In addition, this function aims to reduce information asymmetry and conflicts of interest between the parties (Arens, 2010). The decision to replace the auditor by the company can be caused by principal-agent problems, namely the separation of ownership and control of the company (Fama & Jensen, 2005). The agency problem can cause the auditor's dependence on his client. Dependence on the auditor causes a conflict with the principle of the auditor as a third party who is required to be independent in carrying out the audit and in providing an opinion on the client's financial statements. This is due to the dependence of the auditor to accommodate the wishes of management in the hope that his engagement with the client will not be interrupted, it can cause a loss of independence from an auditor.

2.2 Upper-Echelon Theory (UET)

Upper echelons theory considers the concept of top management as the main strategic decision maker in the organization. Thus, strategic decisions made by leaders have a direct impact on organizational outcomes. Because executives have responsibility for the organization as a whole, their characteristics, what they do, and how they do it, in particular affect organizational outcomes. (Carpenter et al., 2004; Hambrick, 2007). The main premise of upper-echelons theory is that executives' experiences, values, and personalities greatly influence their interpretation of the situation at hand and influence their choices. A focus on the characteristics of top management will produce a stronger explanation of organizational outcomes than a focus on individual top executives.

CEO turnover is an important issue that has the potential to have an impact on the company's strategy, and in turn on the company's performance (Zhang et al., 2016). Cases concerning accounting scandals that led to CEO and auditor changes include the CEO of Enron, Jeffrey Skilling, suddenly resigning in August 2001, less than three months before the company's accounting problems were revealed to the public. Kenneth Lay, who continued as CEO when Skilling left, resigned in February 2002. The audit firm that was Enron's auditor, Arthur Andersen, was dissolved after receiving criminal indictments. Worldcom CEO Bernard Ebbers resigned shortly after his company committed a $3.8 billion accounting fraud and was followed by the resignation of its auditor, Arthur Andersen (Agrawal & Cooper, 2017).

Lindrianasari (2015) conducts research related to CEO resignation. The test results stated that the CEO's personality consisting of openness, conscientiousness, extraversion, agreeableness, and neuroticism played an important role in the decision to resign the auditor.

2.3 Auditor Resignation

Changes in auditors outside the applicable rules can occur for two reasons, namely because of the client's decision to dismiss the auditor or the departure of the auditor from the client (Tanyi et al., 2010). Companies that change auditors show misunderstandings between auditors and managers regarding accounting or auditing matters. When the relationship between the auditor and his client is damaged, the auditor may decide to leave the job or vice versa, the auditor is fired by the client (Lindrianasari, 2013).

Auditor dismissal and auditor resignation can indicate different signals about the client (Griffin & Lont, 2007). Resignations generally convey a negative signal implying that the auditor has considered the engagement too risky (Y. Huang & Scholz, 2012). Resignations are usually bad news for clients, triggering a negative market price reaction and triggering expensive switching costs to new auditors who are often of lower quality. (Raghunandan & Rama, 1999; Wells & Loudder, 1997). The negative market response is most likely because the market interprets the resignation as a signal that the auditor has adverse personal information about the company's financial condition and or other risks.

Previous research has shown that auditor resignation has an effect on clients' poor financial performance and other risk-increasing measures, such as disagreements over accounting issues. (Bell et al., 2001; Beneish et al., 2005; J. Krishnan & Krishnan, 1997; Pratt & Stice, 1994; Shu, 2000). Other studies have also found that resignation sends a more negative signal about the company's risk than dismissal (Catanach et al., 2011; Griffin & Lont, 2010; G. V. Krishnan et al., 2013). uditor resignation is measured using a dichotomous measure, namely:

1 = There is auditor resignation

0 = There is no auditor resignation

2.4 Financial Performance

The company's performance is related to the financial statements issued or issued by an entity. Financial performance is used to find out about the activities that have been carried out by an entity during a period. Financial performance can be analyzed using many measurements, but in this study the measurement of financial performance using the analysis of the ratio of return on assets. Nugroho (2015) said that profitability shows the company's success in generating profits. An unhealthy company's financial condition is a condition where the company experiences financial difficulties so that it is feared that it will go bankrupt. Clients with weak future financial prospects can also create risks for the auditor. Several studies have shown that financial condition proxies differentiate auditor resignation and dismissal (Boone & Raman, 2001; Defond, 1998; Ghosh & Tang, 2015; Nugroho, 2015; Schneider, 2015). The potential for a company's financial difficulties is a matter of concern to creditors, investors and managers. Although financial difficulties do not always lead to corporate bankruptcy, financial difficulties can result in substantial financial losses for the company's creditors and investors (Jacoby et al., 2019).

2.5 Audit Fee

The audit fee is the amount of fees incurred by the external auditor service user, so the amount of the fee that is income for the KAP depends on how complex and wide the audit scope is and the reputation of the KAP in the community, government and investors. (Hay & Davis, 2004), 1981). Previous research on audit fees was carried out by (Barron et al., 2001; Bell et al., 2001; Lyon & Maher, 2005; Morgan & Stocken, 1998; Seetharaman et al., 2002; Simunic & Stein, 1996; Venkataraman et al., 2008) explain that the client's business risk can affect the audit fee. Client companies that experience business risk will be at greater risk because they lack the necessary resources to prepare reliable financial statements. Companies also face pressure to deliberately manipulate financial statements to hide declining company performance. Therefore, a high risk of material misstatement motivates the auditor to perform more audit procedures in order to achieve an acceptable level of audit risk. This can lead to an increase in audit fees (Stanley & DeZoort, 2007).

3. METHODOLOGY

Based on data obtained through www.idx.co.id, the population used in this study are financial sector companies listed on the IDX during the period 2011-2020. The sample was selected using purposive sampling method and obtained as many as 250 observational data from 25 companies that matched the research criteria.

4. RESULTS

The data from the annual financial statements of the sample companies are then processed using SPSS 26, after the output from the results of running data in SPSS 26 comes out, the results of the analysis are as follows:

Table 4.1
Case Processing Summary

Unweighted Cases[a]		N	Percent
Selected Cases	Included in Analysis	250	100.0
	Missing Cases	0	.0
	Total	250	100.0
Unselected Cases		0	.0
Total		250	100.0

Source: Prepared by the authors (2022)

This study uses 250 observational data taken from the annual reports of financial sector companies listed on the Indonesia Stock Exchange with the year of observation from 2011 to 2020. In the table above, it can be seen that there are no missing cases, so the data processed is 250 data.

Table 4.2
Classification Table a,b

			Predicted		
			Auditor Resignation		Percentage Correct
	Observed		There is no auditor resignation	There is auditor resignation	
Step 0	Auditor Resignation	There is no auditor resignation	227	0	100.0
		There is auditor resignation	23	0	.0
	Overall Percentage				90.8

a. Constant is included in the model.
b.The cut value is ,500

Source: Prepared by the authors (2022)

From table 4.2 above, it can be seen that from a sample of 250 annual reports, 227 did not resign, while 23 did. The overall percentage value before the independent variables were included in the model was 90.8%.

Assessing Model Fit

Table 4.3
Hosmer and Lemeshow Test

Step	Chi-square	df	Sig.
1	10.458	8	0.234

Source: Prepared by the authors (2022)

Hypothesis:

H_0: The model formed fits the observational data.

H_a: The model formed does not match the observed data.

Decision making basis:

If the value of Sig. Hosmer and Lemeshow Test > 0.05 then H_0 is accepted.

If the value of Sig. Hosmer and Lemeshow Test < 0.05 then H_a is accepted.

From table 4.3 above, it can be seen that the significance value shows a number of 0.234. This value is greater than the significance of 0.05 (0.234 > 0.05) so that H_0 can be accepted. This means that the model fits the observational data, thus this logistic regression model is feasible to be used in a further stage.

Table 4.4
Iteration History[a,b,c]

Iteration	-2 Log likelihood
Step 0	153.570
Step 1	51.798

Source: Prepared by the authors (2022)

Table 4.4 Iteration History Step 0 presents the output results that in this study when the X variable is not included in the model, the value of -2 Log Likelihood is 153,570. Meanwhile, in step 1, when the X variable is included in the model, the value of -2 Log Likelihood has decreased to 51,798. This shows that the regression model is better. The next step is to compare the value of -2 Log likelihood step 1 with the value of the chi square table. Degree of Freedom (DF) is N-K-1, where N is the number of samples and K is the number of independent variables. The DF value is 250-4-1 = 246, with an alpha value of 0.05, the chi square table value is 283.586. The value of -2 Log likelihood is smaller than the value of the chi square table (51.798 < 283.586) so it can be said that the logistic regression equation is feasible to use.

4.2.2 Coefficient of Determination (Nagelkerke R Square)

Table 4.5

Model Summary

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	51.798[a]	0.334	0.729

a. Estimation terminated at iteration number 9 because parameter estimates changed by less than ,001.

Source: Prepared by the authors (2022)

The Nagelkerke R Square value of 0.55 indicates that the magnitude of the influence of the independent variable (CEO turnover, Financial Performance, and Audit Fee) on the dependent variable (Auditor resignation) is 72.9%.

4.2.3 Pengujian Hipotesis

Tabel 4.6

Variables in the Equation

		B	S.E.	Wald	df	Sig.	Exp(B)
Step 1[a]	CEO turnover	5.364	1.260	18.115	1	0.000	213.637
	Financial Performance	-1.570	0.462	11.568	1	0.001	0.208
	Audit Fee	-1.186	0.865	1.878	1	0.171	0.306
	Constant	7.338	7.698	0.909	1	0.340	1538.331

a. Variable(s) entered on step 1: CEO turnover, Financial Performance, Audit Fee.

Source: Prepared by the authors (2022)

From the table above, it can be seen that the significant value for the CEO turnover variable (X1) is 0.000. This figure is smaller than the research alpha (0.000 < 0.05). That is, partially CEO turnover significantly affects auditor resignation. Financial Performance Variable (X2) has a significance value of 0.001. This number is smaller than the research alpha (0.001 < 0.05), with a negative coefficient value. This means that partially the financial condition significantly affects the auditor's resignation. The audit fee variable (X3) is 0.171.

This value is greater than the research alpha (0.171 > 0.05). This means that partially audit fees do not significantly affect the resignation of auditors in financial sector companies listed on the IDX.

4.2.4.2 Omnibus Tests of Model Coefficients (Simultaneous Test f)

Table 4.7
Omnibus Tests of Model Coefficients

		Chi-square	df	Sig.
Step 1	Step	72,758	4	0,000
	Block	72,758	4	0,000
	Model	72,758	4	0,000

Source: Prepared by the authors (2022)

Based on table 4.7 it can be seen that the significance value of 0.000 is smaller than 0.05 so it can be concluded that CEO turnover, financial performance, and audit fees simultaneously affect the resignation of the auditor.

5. DISCUSSION

The results of hypothesis testing prove that CEO turnover has a significant positive effect on auditor resignation. Based on these results, if the company changes its CEO, it will increase the chances of auditor resignation. Agency theory says it is hard to believe that management (CEO) will always act in the interests of shareholders (principals). Changes in management cause the company to contract or replace a new president director or CEO (Chief Executive Officer). CEO turnover is an important issue that has the potential to have an impact on the company's strategy, and in turn on the company's performance (Zhang et al., 2016).

Return on Assets is a proxy for company performance (Rahayu, 2014). Changes in ROA can be used as an indicator of the company's financial condition to see the company's business prospects. The higher the ROA value means the more effective the management of assets owned by the company and the better the business prospects (Wibowo & Rahmawati, 2019). Companies that have a lower ROA value tend to switch auditors due to a decrease in performance so that business prospects decline. Previous research has shown that auditor resignation has an effect on clients' poor financial performance and other risk-increasing measures, such as disagreements over accounting issues (Khalil et al., 2011; Kurklu & Turk, 2020; Tanyi et al., 2010).

When auditing a client for the first time, the first thing the auditor does is understand the client's business environment and audit risks. This results in high initial costs and can increase audit fees. In addition, the first assignment also allows high errors. Payment of expensive audit fees under certain conditions will further burden the company. The size of the audit fee received by the auditor does not affect the auditor in making the decision to resign, but rather the audit risk faced. This can happen because the determination of the fee for audit services has been officially regulated by regulations, so it does not directly affect the quality of the audit.

6. CONCLUSION

This study aims to provide empirical evidence of the impact of CEO turnover (Chief Executive Officer), financial performance, and audit fees on indications of auditor resignation. The results of testing the first hypothesis show that CEO turnover has a significant positive effect on auditor resignation. Based on these results, if the company changes its CEO, it will increase the chances of auditor resignation. Agency theory says it is difficult to believe that management (CEO) will always act in the interests of shareholders (principals). The results of the second hypothesis test show that financial performance as a proxy using Return On Asstes (ROA) has a significant positive effect on auditor resignation. This indicates that auditor resignation has an effect on the client's poor financial performance and other risk-increasing measures, such as disagreements over accounting issues. Testing the third hypothesis shows that audit fees have no effect on auditor resignation. The size of the audit fee received by the auditor does not affect the auditor in making the decision to resign from the assignment.

Limitations and further studies

This study has limitations, including that in this study only the population and samples from financial sector companies were used, so the results of the study could not be generalized to all types of industries. The limited observation period is also a limitation in the study, it is possible that different results will be displayed when the observation period is longer. As a hope for the development of further research, the addition of other variables that can affect the indication of the auditor's resignation. Further researchers are also advised to use a wider sample and a longer year of observation.

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