

AUDIT OPINION, FINANCIAL DISTRESS AND FIRM SIZE ON AUDITOR SWITCHING: EVIDENCE FROM EMERGING MARKETS IN INDONESIA

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Abstract

The phenomenon of auditor switching in emerging market countries is attracting increasing attention, particularly amidst economic uncertainty and information asymmetry, which are driving companies to be more cautious in maintaining the credibility of their financial reports. Food and beverage manufacturing companies in Indonesia are required to maintain investor trust by ensuring high-quality financial reports.

In line with this phenomenon, this study aims to analyze the impact of audit opinion, financial distress, and firm size on auditor switching. This study uses a quantitative, associative approach and analyzes panel data using EViews 10 software. The data used are financial statements and annual reports from 2020 to 2024, covering 28 companies with a total of 140 observations.

This study shows that audit opinion significantly influences a company's decision to switch auditors, but financial distress and company size do not. This suggests that auditor switching is more influenced by the audit opinion outcome than by financial distress and company size.

Companies are encouraged to improve the quality of their financial reports and maintain professional relationships with their auditors. This is crucial for obtaining a good audit opinion and increasing investor confidence in the market.

Keyword: *Emerging Markets, Audit Opinion, Financial Distress, Firm Size, Auditor Switching.*

Introduction

Emerging markets are economies transitioning toward developed status, marked by rising GDP growth, industrial expansion, and growing global integration. Indonesia is classified as a Secondary Emerging Market by FTSE Russell, reflecting a developing capital market but still facing structural challenges—especially in financial transparency and audit quality. In such environments, information asymmetry between management and external stakeholders is high, making the role of external auditors critical as independent verifiers of financial statements.

Auditor switching—the replacement of a public accounting firm—can occur either mandatorily (per regulation, maximum 5 consecutive years) or voluntarily. Voluntary changes often raise market concerns, so understanding their determinants is essential. Previous studies have produced mixed findings: some show audit opinion influences switching, while others find no effect; similarly, results for financial distress and firm size vary across sectors and countries.

This study focuses on the food and beverage manufacturing sector listed on the Indonesia Stock Exchange (IDX) from 2020 to 2024. This sector is chosen for its stable operational activity, complete data availability, and observable variation in audit outcomes and auditor changes. The research fills a gap by providing empirical evidence specific to emerging market conditions in Indonesia.

Research Questions

- (1) Does audit opinion significantly affect auditor switching?
- (2) Does financial distress significantly affect auditor switching?
- (3) Does firm size significantly affect auditor switching?

Research Objectives

- (1) To analyzing the influence of audit opinion on auditor switching.
- (2) To analyzing the influence of financial distress on auditor switching.
- (3) To analyzing the influence of firm size on auditor switching.

LITERATURE REVIEW

Agency Theory

Developed by Jensen and Meckling (1976), agency theory explains the relationship between principals (owners) and agents (management). Conflicts arise when management prioritizes personal interests over those of shareholders. Auditors serve as independent intermediaries to reduce information asymmetry. When auditors issue opinions unfavorable to management, companies may switch auditors to obtain more favorable assessments.

Signaling Theory

This theory suggests that company actions convey information to external parties. Switching auditors can signal efforts to improve reporting quality or, conversely, attempts to hide poor financial performance. Audit opinions and financial conditions also act as signals affecting investor perception and market confidence.

Audit Opinion

Audit opinion represents the auditor's judgment on the fairness of financial statements. Opinions range from unqualified to qualified, adverse, or disclaimer. Non-standard opinions may motivate management to change auditors to restore credibility.

Financial Distress

Financial distress refers to conditions where companies struggle to meet obligations or face going-concern risks. Distressed firms may switch auditors to reduce costs, obtain more favorable opinions, or restructure reporting.

Firm Size

Firm size reflects company scale, typically measured by total assets. Larger companies often maintain stable auditor relationships to preserve reputation, while smaller firms may change auditors more frequently due to cost considerations.

RESEARCH METHOD

Research Design

This is a quantitative associative study using panel data (combination of time series and cross-section). It aims to identify causal relationships between independent variables (audit opinion, financial distress, firm size) and the dependent variable (auditor switching).

Population and Sample

The population includes food and beverage manufacturing companies listed on the Indonesia Stock Exchange. Using purposive sampling, 28 companies meeting data completeness criteria were selected, resulting in 140 observations.

Data Collection

Secondary data obtained from official IDX website (www.idx.co.id) and company annual reports. Data processed using Microsoft Excel and EViews 10.

Variable Operationalization

Table 1. Operational Definition of Variables

Variable	Definition	Measurement
Auditor Switching (Y)	Change of auditor from one period to next	Dummy: 1 = Switch; 0 = No switch
Audit Opinion (X1)	Auditor's statement on fairness of financial report	Dummy: 1 = Unqualified; 0 = Qualified/Adverse/Disclaimer
Financial Distress (X2)	Level of financial difficulty	DER = Total Liabilities / Total Equity
Firm Size (X3)	Scale of company assets	Ln(Total Assets)

Data Analysis Technique

Descriptive statistics were calculated including the mean, median, standard deviation, minimum, and maximum. For panel data regression, we estimated the Common Effect Model (CEM), Fixed Effect Model (FEM), and Random Effect Model (REM). Model selection was conducted using the Chow test, Hausman test, and Lagrange Multiplier test. Classical assumption checks included multicollinearity assessment using Variance Inflation Factor (VIF) with $VIF < 10$ considered acceptable, and heteroskedasticity testing using the Glejser test. Hypotheses were tested with t-tests at the 5% significance level ($\alpha = 0.05$), and model explanatory power was evaluated using the coefficient of determination (R^2).

Results and Discussions

Descriptive Statistics

Table 2. Descriptive Statistical Results

	X1	X2	X3	Y
Mean	0.550725	107909.3	2853.703	0.521739
Median	1.000000	85782.50	2852.500	1.000000
Maximum	1.000000	741959.0	3102.000	1.000000
Minimum	0.000000	10023.00	1707.000	0.000000
Std. Dev.	0.499232	113500.3	145.4113	0.501347
Observations	140	140	140	140

Source: Data processed with EViews 10, January 2026

Audit Opinion shows that 55% of firms received unqualified opinions. Financial distress exhibits high variation, with some firms displaying very high leverage. Firm size is generally large and asset values are relatively stable. Auditor switching occurred in approximately 52% of firms during the observation period. For model selection, the Chow test yielded Prob = 0.8647 (> 0.05), indicating a Common Effect Model is preferred. The Hausman test yielded Prob = 0.1910 (> 0.05), so the Random Effect Model was not chosen. The Lagrange Multiplier test produced Prob = 0.1785 (> 0.05), confirming the Common Effect Model as the best fit. Regarding classical assumptions, multicollinearity was not present (all VIF values < 10), and no heteroskedasticity was detected (all test p-values > 0.05).

Regression and Hypothesis Test Results

Table 3. Panel Regression Results (Common Effect Model)

Variable	Coefficient	t-Statistic	Prob.	Conclusion
C	-0.0093	-0.0112	0.9911	—
X1 (Audit Opinion)	-0.1914	-2.2442	0.0265	Significant (H1 Accepted)
X2 (Financial Distress)	3.38E-07	0.9021	0.3686	Not Significant (H2 Rejected)
X3 (Firm Size)	0.0002	0.7213	0.4720	Not Significant (H3 Rejected)

Regression Equation:

$$Y = -0.0093 - 0.1914 X1 + 0.000000338 X2 + 0.00021 X3$$

Coefficient of Determination:

*Adjusted R*² = 0.0359 → Model explains only 3.59% of variation in auditor switching; remaining 96.41% influenced by other factors (e.g., audit fees, management changes, regulation).

Discussion

Effect of Audit Opinion

Audit opinion has a **significant negative effect** ($p < 0.05$). Firms receiving opinions *other than unqualified* are more likely to switch auditors. This aligns with Agency Theory: management seeks favorable assessments to maintain reputation. In emerging markets, where trust is fragile, an unfavorable audit is viewed as a negative signal, prompting firms to change auditors to restore confidence. Consistent with findings by Sinaga et al. (2021) and Tjahjono & Khairunissa (2021).

Effect of Financial Distress

No significant relationship ($p > 0.05$). Even in financial difficulty, firms tend to retain auditors to avoid additional costs, disruption, or sending negative signals to the market. This supports results from Sinaga et al. (2021), contrary to studies suggesting distressed firms switch to hide poor performance.

Effect of Firm Size

No significant relationship ($p > 0.05$). Both large and small firms in this sector show similar switching patterns, likely due to uniform regulatory rotation rules and stable operational characteristics. Size does not determine auditor choice in this context.

Conclusion

Audit opinion significantly influences auditor switching: companies that receive non-unqualified opinions are more likely to replace their auditors. Financial distress has no significant effect, indicating that financial difficulty is not a primary reason for auditor changes. Firm size similarly shows no significant effect, suggesting company scale does not affect the decision to switch auditors. In the context of Indonesia's emerging market, audit outcomes appear to be the main driver of auditor changes, outweighing both financial condition and firm size.

Recommendations

For companies, strengthen internal controls and improve financial reporting quality to secure favorable audit opinions. For auditors, maintain independence and uphold high professional standards to reduce client turnover. For regulators, enforce transparency and disclosure requirements to deter —opinion shopping. For future research, consider including additional variables such as audit fees, corporate governance, or auditor reputation, and expand the study to other sectors to enhance generalizability.

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