THE DETERMINANTS OF AUDITOR SWITCHING IN CHINA

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ABSTRACT

Auditor plays a crucial role in providing credibility of financial disclosure and mitigating the agency problems. However, there is high trend of auditor switching in China. This could lead to a series of negative effects to both company and society. Although there were many past empirical studies examined the determinants of auditor switching, those studies were conducted in different countries with different national conditions which may not appropriate and suitable to China context. Thus, it is necessary to conduct this study to investigate the determinants of auditor switching and to examine the relationship between determinants of auditor switching in China context. This study used data of A-share listed companies from Shanghai Stock Exchange. The sample of this study consists of 182 listed companies from the period of year 2012 to 2014. Moreover, this study employed Logistic Regression Model to examine the determinants of auditor switching. This study measured four determinants, which are going concern issue, ownership concentration, leverage, and big audit firm. The finding shows that big audit firm is significantly and negatively related to auditor switching. Therefore, this study recommended that based on the special national conditions of China, more variables could be investigated in the future research and the implications of auditor switching, such as implications of auditor switching on audit quality or audit independence, could be investigated.

Keyword: Auditor switch, going concern issue, ownership concentration, leverage, big audit firm

ABSTRAK

Juruaudit memainkan peranan yang penting dalam menentukan kebolehpercayaan pendedahan kewangan dan mengurangkan masalah agensi. Namun begitu, terdapat kecenderungan yang tinggi berkaitan pertukaran juruaudit di negara China. Hal ini boleh memberikan kesan yang negatif terhadap syarikat dan masyarakat. Meskipun terdapat banyak kajian lepas berbentuk empirikal yang meneliti aspek penentu pertukaran juruaudit, namun kajian tersebut dilaksanakan di negara yang berbeza dengan keadaan negara yang tidak sama yang mungkin tidak sesuai dengan konteks di negara China. Oleh yang demikian, penting untuk kajian ini dilakukan untuk menyelidik penentu pertukaran juruaudit dan meneliti hubungan antara penentu pertukaran juruaudit dalam konteks di China. Kajian ini mengupayakan data daripada syarikat saham kumpulan A yang tersenarai dalam Bursa Saham Shanghai. Sampel kajian terdiri daripada 182 syarikat yang tersenarai dari tahun 2012 hingga 2014. Selain itu, kajian juga menggunakan Model Regresi Logistik untuk menyelidik penentu pertukaran juruaudit. Kajian ini mengukur empat penentu, khususnya isu yang melibatkan peninggalan, tumpuan pemilikan, keumpilan dan firma syarikat yang besar. Dapatan memperlihatkan bahawa firma audit yang besar mempunyai hubungan yang signifikan dan negatif dengan pertukaran juruaudit. Kajian ini menyarankan agar lebih banyak pemboleh ubah diteliti dalam kajian yang akan datang memandangkan keadaan negara China yang agak istimewa. Implikasi pertukaran juruaudit seperti implikasi pertukaran juruaudit terhadap kualiti audit atau kebebasan audit juga perlu dikaji.

Kata kunci: Pertukaran juruadit, isu yang melibatkan peninggalan, tumpuan pemilikan, keumpilan, firma audit yang besar

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TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

LIST OF ABBREVIATIONS

CEO	Chief Executive Officer
CICPA	Chinese Institute of Certified Public Accountants
IAASB	International Auditing and Assurance Standards Board
ROA	Return on Assets
SOEs	State Owned Enterprises

CHAPTER ONE

INTRODUCTION

1.1 Introduction to the study

Business cannot run without money. Thus, companies need huge financial capital to support their business activities. There is a necessary for the companies to report their company performance and financial position in order to get easy access to their capital sources (Siegel and Shaughnessy, 2008). Based on this condition, there is an increased desire to acquire auditors with independence characteristic providing audit service in order to enhance credibility of the firm's financial statements being prepared, as the justification and reliability added to the auditors' opinions in the financial statements (Chadegani, Mohamed, and Jari, 2011). Reliable financial reports provide useful and valuable information to the managers, investors, creditors and government. Furthermore, those users of financial statement always rely on the financial information that only after the reliability of the information is confirmed by the independent auditor. Therefore, the reputable auditors are employed by firms to assure outside investors the credibility of financial disclosures and to mitigate the agency problems (Anderson, Kadous and Koonce, 2004).

The security market always plays an important role in the market economy development, especially in China. The efficient and safe security market needs to rely much on the disclosed accounting information. Therefore, it is important to know that the certified auditors always take responsibility for the true accounting information disclosure. Thus, auditor switching will affect the information disclosure

of the listed companies which may have impact on investors' decision making, accounting forms' judgements. Moreover, Auditor switch may have impact on the independent feature of auditor and may compromise the credibility of the audited financial statements (Woo and Koh, 2001).

However, independence characteristic of the auditors is very important, without the existence of the independence, the audit service will not have any added value to the user's perception. Changing the existing auditor is also costly in terms of incremental financial and managerial time required to select and familiarize a new auditor. Changing existing auditor means forgoing any firm specific expertise developed by the existing auditor throughout the past few years of audit (Hennes, Leone, and Miller, 2010).

In the recent years, firms all over the world have been switching auditors at a higher rate, so that there is a necessary to know the reasons behind these changes. Regarding to the implications of auditors switching on auditors independence, it is important to find the major influential factors of auditor switching.

Based on previous studies, the factors may have impact on auditor switching have been examined, such as disagreement between auditor and managements about the content of financial reports (Addams and Davis, 1994) and auditor opinion (Haskins and Williams, 1990), management changes (Beattie and Fearnley, 1995), auditor fees (Addams and Davis, 1994), and financial conditions of the client firm such as

financial distress or bankruptcy (Chen et al., 2005), audit firm reputation and tenure of auditor (Khasanah and Nahumury, 2013). These factors may cause auditor switching and those factors would compromise the auditor's independence as well.

In China, it is difficult to know about the reasons of auditor change from the published information, because there is no legal requirement for companies to disclose the information. Based on this situation, it is necessary to understand the determinants which will cause listed companies to change auditors. The emerging competitive market in China has created an increased desire for researchers to study the unique features in China context. This study will examine the particularly factors related to auditor switch in the emerging market of China. Through this study, it will provide valuable information on the reasons of auditor switching in China context. Moreover, such valuable information will be useful for the companies and future researches.

1.2 Background of the problem

In China, the development of market economy largely relies on the security market. However, China's security market is still an immature and fresh market comparing to European countries, due to the securities market of China has only developed for little more than 20 years since Shanghai Securities Exchange was established in 1990. In the mean while, auditing plays a crucial role in increasing the reliability and quality of the financial performance and the auditors take main responsibility in the

accounting information disclosure in turns determining the efficient and safe security market.

In the recent years, auditor switching especially among listed companies has become an increased concern in both public sector and research areas. Based on the China context, due to the short time of security market, there was little attention has been paid from the government. However, as the increased frequency of auditor switching among listed companies, it has drawn more attention from the academics and regulators (Yanan, Wen, and Jinzheng, 2013). Moreover, the studies in auditor switching still need further researches to investigate the factors influencing auditor switching based on the specific country's conditions.

Previous researches have examined various factors affecting auditor switch in different countries. These factors have been examined in prior studies, such as audit fees (Addams and Davis, 1994; Branson and Breesch, 2004; Ettredge, Li and Scholz, 2007; Ebrahim, 2010; Nyakuwanika, 2014), financial distress (Chen et al., 2005; weiss and Kalbers,2008; Suyono, Yi, and Riswan, 2013), size of client firm (Copley and Douthett, 2002; Sriram, 2006; Mazri et al., 2012; Nyakuwanika, 2014), change of management (Beattie and Fearnley, 1995; Huson et al., 2001; Woo and Koh, 2001; Branson and Breesch, 2004; Mazri et al., 2012; Nyakuwanika, 2014), auditor opinion (Krishnan,1994; Geng and Yang, 2001; Woo and Koh, 2001; Nyakuwanika, 2014), financial statements (Huang and Scholz, 2012), level of complexity (Mazri et al., 2012; Cheng et al., 2014), leverage (Woo and Koh, 2001; Ismail and Aliahmed,

2008), disagreement between auditor and client (Huang and Scholz, 2012; Al-Koury et al., 2015).

According to China context, high ownership can be the distinctive feature in the listed companies, due to the firms in China were under the state ownership after the founding of China in the year of 1949, auditing professions in China were completely diminished during that time. Then after the mushrooming Sino-foreign joint ventures, Chinese government adopted the "open-door" policy in the early of 1980s, there was an increased demand to involve non-state equity interest in the joint-ventures, the independent professionals have become necessary to verify capital contributions and audit the financial statements and income tax returns. Therefore, in the early of 1980s, Chinese government established the Chinese Institute of Certified Public Accountants (CICPA) and followed by the business restructuring, after that, in the 1990s the shareholding companies reappeared. Thus, today the most of listed companies of China were restructured from the former state-owned enterprises (SOEs). The listed firms in China are normally in three types of equity holding: the state-owned shares which representing the state's interest; the social-legal-entity shares witch representing the interest of the parent SOEs or other social agencies; the public shares, holding by the institutional and individual investors and the major part of the total shares are controlled by the state or parent SOEs (Lin and Liu, 2009).

According to Lin and Liu (2009) that independent auditing function requires auditors to disclose the earnings management and other misconducts committed by the managements or large shareholders. Hence, the large controlling shareholders may

like to engage in influencing auditor choice decisions or auditor switches in order to protect their own self-interests. Moreover, if the present auditor issued an unclean audit report which may conflict in large shareholder self interests, the large shareholders may prefer to look for a more pliable auditor in favour to mitigate the adverse impact of issued unclean audit report on the firm's market stock price, and on the controlling shareholders' own self interests.

Moreover, there is a rising concern of going concern issue in China. In 1999, the Chinese Institute of Certified Accountants (CICPA) issued the third batch of auditing standards which are broadly based upon International Standards, and the Specific Independent Auditing Standards about going concern were issued in the same time. However, the standards associated with some criticisms, because that the new standards still lack of guidance for the field work. For this reason, auditors may give different opinion about the similar situation. Thus, in 2003, they amended this standard of going concern. More detailed auditing procedures prescribed in the updated standards, it requires auditors to explicitly evaluate whether a firm has ability to continue their business as a going concern over the following year. Further, if the auditor has any query on it, it's necessary to issue the opinion in their audit report. In order to comply with the new standards, auditors are required to oversee the management plan, company's strategies, financial and business stress as well. Auditors are in charge of understanding and assessing existing conditions including those of other companies in the same industry and the economy in general. However, auditors are not required to predict clients' future conditions or events. Then, during the year of 2006, another auditing standard No.1324 about going concern was issued to replace the old one. The new standards maintained the core content of the old

standards but emphasized that the auditors should give opinion to any event that may lead to the client failure (Hao, Hall, Street, and Wang, 2011).

1.3 Statement of the problem

Currently, the increased high rate of auditor switching and the impact of auditor switching on auditor's independence has become a crucial issue, and such issues are studied widely among developed and developing countries. However, there are few studies have been done to investigate the factors that could influence the auditor switching among listed companies in China (Chen, 2007; Lin and Liu, 2009).

Moreover, the recent empirical investigations have shown that the Chinese firms with larger controlling owners, namely the board of directors and chief executive officer (CEO) are held by the same person, have a high tendency to change their auditors. According to Lin and Liu (2009), high ownership concentration is the unique characteristic of the Chinese listed firms. The listed companies of China usually have large controlling shareholders which may have a dominant influence on decision of auditor switching.

Furthermore, there was no study conducted in China context focus on the going concern issues which may have significant impact on auditor switching. The going concern opinion which issued by the auditors always play a significant role in the decision making of investors, due to the auditors are expected by the market to

provide warning information of approaching financial failure by issuing a going-concern opinion, and those opinion can be seen as a prediction of bankruptcy.

Therefore, there is a necessary to conduct this research work to investigate the major determinants of auditor switching in China context.

1.4 Research questions

The research questions are as follow:

1. Is there a relationship between going concern issue and auditor switching?
2. Is there a relationship between ownership concentration and auditor switching?
3. Is there a relationship between leverage and auditor switching?
4. Is there a relationship between big audit firm and auditor switching?

1.5 Objective of study

The objectives of this study are:

1. To examine the relationship between going concern issues and auditor switching.
2. To examine the relationship between ownership concentration and auditor switching.
3. To examine the relationship between leverage and auditor switching.
4. To examine the relationship between big audit firm and auditor switching.

1.6 Significant of the study

The most studies on auditor switch have been conducted in the developed countries and some in developing countries but there is few studies based on China context. Also, many prior studies examine the determinants on auditor switch such as client size, audit fee, auditor opinion, and change of management. (Woo and Koh, 2001; Ebrahim, 2010; Mazri et al., 2012; Nyakuwanika, 2014). Hence, this study contributes to seek particular determinants of auditor switch regarding to China context, such as going concern issue and ownership concentration. This study will help enrich the researches on Chinese context in terms of auditor switching and even auditing.

Moreover, this study provides useful information for the auditors, investors and firm's management to realise the factors which would influence the decision of auditor switch. The determinants that affect audit switching may have impact on audit independence characteristic and in turn to influence audit quality. Moreover, this study also can provide the idea to investors and management about a potential problem that may occur in their future, this will help them to eliminate the difficulties that they may faced regarding to auditor changes.

1.7 Organization of Remaining Sections

Having introduced the research problem, objectives of this study, research questions, and significant of the study, in the next Chapter of this paper provides an overview of

each variable which influenced auditor switching and then summarize the literature, followed by theoretical framework and hypotheses development. Chapter three describes the methodology. Chapter four discusses the results and findings of this study. In the last chapter, summary, implication, limitation and conclusion are exhibited.

CHAPTER TWO

LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

2.1 Introduction

Following the overview of this research, Chapter two reviews literature in the past studies that related to auditor switches. Each variable of this study including auditor switch, going concern, ownership concentration, leverage, big audit firm, and two theories (agency theory and signalling theory) related to auditor switches are also discussed in the next sections. Then research Framework provides an overview of the relationship between dependent variable and independent variables. This chapter is end with hypotheses development.

2.2 Literature Review

2.2.1 Auditor switch

A number of studies have been conducted regarding to auditor switches and auditor selections. Auditor switching is the client company changes a public accounting firm (Khasanah and Nahumury, 2013). There are two ways of this change, either mandatory or voluntary. There is no doubt for mandatory because that there are regulations to govern auditor rotation obligations. A study by Khasanah and Nahumury (2013) has examined that the causal factors for voluntary changes can be from the client side and the auditor. Auditor removal or resignation from client firm can be regarded as the auditor change (Turner, Williams and Weirich, 2005). According to Huson, Ali, Annuar, Ariff and Shamsheer (2000) that auditor change

can be known as the decisions of firm's management to change or retain their auditors when the firm's characteristics changes.

Auditor switch affected by different factors regarding to particular country's context, and auditor switch would have impact on auditor independence and may compromise the audited financial statements' credibility as well. However, the independent feature of auditors can be considered as one of the most important principles of the auditor function (Younkins, 1983; Prevists, 1985; Woo and Koh, 2001; Khasharmeh, 2015). According to Meigs et al., (1974) that if auditor cannot comply with the independence principle, there would be a decrease in the value of audited financial statements and this would lead to uncertainty in the activities of investment in capital market. The value or the credibility of audited financial statements could be recognized if the auditor is independent of the client firm.

A recent study of auditor switching conducted by Black, Burton and Maggina (2012) examined the reasons for firms that switch and do not switch auditors. This study has examined financial ratios by using discriminate and logistic regression method to explain the decision of companies that switching their auditors.

Suyono et al., (2013) investigated the determinants of auditor switching in Indonesian. This study used a survey method by distributing questionnaires to respondents. Several factors have been examined in this research. The finding shows that the financial condition of the client firms, level of competition among audit

firms, and audit tenure have significant impact on auditor switching, while the other two factors, such as size of audit firm and audit fee, do not affect auditor switching.

Al-Bawab (2012) conducted an empirical study to investigate the determinants of the choice of external auditor in banks from the external auditors' perspective in Jordan. This research has concluded several reasons of auditor changes related to the banks of Jordan, the application of generally accepted auditing standards, and audit office.

Khasanah and Nahumury (2013) mentioned that corporate management change their auditors due to the purpose of requiring better audit quality service, an expected opinion and lower audit fees. Thus, the study adopted logistic regression model to examine factors such as management change, auditor opinion, and size of audit firm, ROA percentage, financial distress and company growth towards auditor switching. Finding shows there are no significant relationship between auditor opinion, change of management, ROA percentage, financial distress, and growth of company towards auditor switching. But size of audit firm affects auditor switching, due to the assumption that big four would provide higher quality compared to non big four.

Study by Siegel and Shaughnessy (2008) discussed the reasons why company change auditors in three European countries, Malta, Spain and the United Kingdom. The finding shows that the quality of auditor and their firm, and the audit fee are the important shift in Malta and the UK, and there is a strong personal relationship between the firm and auditor in Malta which would influence auditor decisions.

While in Spain the qualified opinion is the major factor of auditor switching, but the auditor or audit quality is not significant to the Spanish companies.

Chadegani et al., (2011) examined major factors affecting auditor switching among listed companies on Tehran stock exchange. This study categorized factors into two groups, one related to auditor and another related to client. The factors related to auditor are qualified audit opinions, audit quality, and audit fee. While, change in management, financial distress, and client size are the factors related client. This research used logistic regression model found that only audit quality has significant relationship with auditor switch in TSE. The result is different with other studies that audit fee and change in management (Nyakuwanika, 2014) play an important role in auditor switch.

Nyakuwanika (2014) investigated the causal factors of Zimbabwe companies to switch auditors. This research aims to seek the relationship existed in auditor switch and various factors such as qualified opinion, audit fees, change in management, audit quality and size of firm. The descriptive research design was employed; primary data from questionnaire and secondary data from several publications was used in this study. The findings indicates that audit fees, audit quality, change in management and size of firm are significant associated with auditor switch in Zimbabwe companies.

According to Anderson et al., (2004) auditor provides reliable financial reports that contained useful information for the managers, investors, government and so on. Those useful information should been confirmed the reliability by the independent auditors. Thus, namely, firms enjoy the assurance of the credibility of financial disclosures to the outside investors by the auditors who with good reputation, in order to mitigate the agency problems. Hence, auditors also play a corporate governance role in firms reporting process.

There is a study by Yanan et al., (2013) investigated the reason of auditor switching from corporate governance perspective. The sample selected from A-share listed companies in China. This study employed statistical test and logistic regression model to examine 15 factors of corporate governance. The findings indicate that corporate governance significantly affects auditor switching. Moreover, the proportion of the largest shareholder rate, independent director rate and board meetings are significantly and negatively associated with auditor switching. The full disclosure, litigation, and arbitration are significantly and positively related to auditor switching.

2.2.2 Going concern issue

Auditors play a trust-creating role to the society, as they are expected to objectively assess the firm's financial position to the shareholders, also, they are expected to provide useful information for the investment decisions making (Sikka et al., 2009). In every year, auditors are expected to issue an audit report covering the going

concern assumption to the client firm. Going concern describes as the client firms' ability to continue its business in its chosen industry in the future (Mohamed et al., 2007). Calderon and Ofobike (2008) argued that going concern can be considered as the indication on if registrant incharged of auditor has disclosed any going concern qualified audit opinion.

Both of the Auditing Standards No.1324 issued by CICPA and Specific Independent Auditing Standards No.17 mentioned that if the auditors have doubt to the company's ability to continue their business in the next twelve months, auditors are required to state going concern opinion in their audit reports (Chinese Auditing Standards Board, 2012). In other words, auditors are required to disclose the risk of clients' business failure or bankruptcy. Furthermore, the auditors are responsible for gathering sufficient and appropriate audit evidence to assess the credibility of initially going concern assessment which is conducted by the management of the client (International Standards on Auditing 570).

In the professional standards, there is no requirement for the auditors to predict the future of the client, but it is required that auditors to objectively estimate the capacity of continuous operation of every organization they audit (Blay et al., 2011). Likewise, in the audit report, auditors are also required to provide awareness and assurance of the credible information that provided to the investors, due to the audit report has become the public record what will attract the attention of the public (Federal Acquisition Regulation No.42, 2013). Therefore, the going concern opinion issued by auditor serves a vital part in providing awareness of company's financial

distress to the shareholders and it also gives a warning of risk of potential bankruptcy (Björkstrand and Nordholm, 2014).

Lin (2014) mentioned that if auditors issued opinions contained the client's going concern uncertainties; it will affect firm's stock prices. More than that, the audit market is always decided by its demand and supply. Thereby, the issuance of negative audit opinions or big changes in business operation would lead to auditor switches. According to Tucker et al. (2003) and Vanstraelen (2003) that a disclosed going concern qualified opinion will cause client bankruptcy or corporate delisting, thus when the clients facing financial distress will always switch their auditors if going concern qualified opinion issued. Delisting may cause auditor switch as well (Lin, 2014).

In the past few years, the International Auditing and Assurance Standards Board (IAASB) have increased focus on going concern issues. In year 2009, IAASB published a report which emphasizes the importance of carrying out a going concern assessment. This published report gives auditors a concern that auditors should carefully consider and evaluate managements' assessment of going concern in every audit engagement. Even if there are no requirements for auditors or management to predict the future, they should take responsibility to conduct going concern evaluations (IAASB, 2009).

Vanstraelen (1999) mentioned that although auditors are able to identify the going concern issue of a company, auditors may not determine to state a going concern opinion in their audit report. Auditors will not issue a going concern opinion unless they can keep independence towards clients and they have courage to go against the client's opinion. Some studies (eg. Carcello and Neal, 2000; Humphrey et al., 2009) have shown that managers or shareholders are not willing to report the potential risk of their company that they may facing going concern problems. Thus, auditor switches may occur if auditors dare to go against managers and use their expertise to issue a going concern opinion.

Managements may attempt to influence the auditors' decision of going concern opinion issuance due to the negative consequences. Because of this reason, clients avoid receiving going concern opinion and influence auditors' decision may be lead to compromise of auditors' independence. Thus there is also some debates that issuance of auditor opinion is representative of heightened auditor independence (Bowler, 2015).

According to Perreault and Kida (2011), in the case of a conflict between auditors and clients, auditors are able to issue a going concern opinion by threatening to strengthen their position, in the same way, if the auditors have conflict with clients' opinion, clients will threaten not to remunerate the auditors in order to strengthen the position of clients (McCracken et al., 2008). This is also consistent with the results of Carcello and Neal (2000) that clients are more likely to switch auditors if they receiving a going concern opinion. However, auditors would choose not to issue

going concern opinion for the purpose of maintaining their position and client satisfaction and avoiding client switching auditor.

There is a debate that going concern judgments of the future uncertainty have potential negative effect on the client's stock price (Björkstrand and Nordholm, 2014). Clients often have an incentive to switch auditors in order to perceive the future differently. Lennox (2000) stated that clients are more likely to switch auditors when they receiving going concern opinions. Furthermore, the motivation of clients to avoid an initial going concern opinion could be more than the motivation to avoid a second going concern opinion (Tucker et al., 2003).

Calderon and Ofobike (2008) examined factors that explain and predict the auditor initiated and client initiated auditor changes, and going concern is one of the factors. The classification and regression trees (CART model) were used in data analyses. This research collect data from Audit Analytical database and the sample of this study comprise of 6,510 auditor changes. The finding of this study shows that going concern is significantly associated with the auditor change.

A study by Vanstrealen (2003) used logistic regression investigated the impact of going concern on client bankruptcy, and examined the association between going concern opinion and auditor switching in Belgium. The study provides evidence that both initial and repeated going concern opinion increased the likelihood of

bankruptcy, and company surviving a going concern opinion increase the likelihood of audit switches.

Jackson, Moldrich and Roebuck (2008) conducted a study to examine the impact of mandatory audit firm rotation on audit quality. Their research measures audit quality from two ways, the tendency to issue a going concern report and the level of discretionary accruals, to investigate the capacity of clients in the voluntary auditor switches and the audit quality level. The sample of 772 auditor switches selected form the Australian listed companies. The finding indicates that audit quality increases with the tenure of audit firm and with higher tendency to issue a going concern opinion, hence reduce the likelihood of auditor switches.

2.2.3 Ownership concentration

According to Woo and Koh (2001) ownership concentration can be defined as the common stock held by the largest shareholder. Bakar (2010) defined ownership concentration as the authority to conduct supervision of the company's portfolio of assets and objectives.

Study by Shleifer and Vishny (1997), they debated that large shareholders usually have desire to gain complete control of the company and acquire private benefits from this full control, which may not match with the interests of the minority shareholders due to that those large shareholders only represent their own interest. For instance, Shleifer and Vishny (1986) argued that large shareholders may be more

interested in dividends, but small shareholders may prefer capital gains. Cleaessens and Fan (2002) pointed that if the large shareholders have dominated control over a firm, they may have rights to arrange corporate contracts with different shareholders and to determine the profit sharing among shareholders. This situation may enable them to engage in self interested behaviour and to avoid obstacle by internal board of director and external takeover market (Fan and Wang, 2005).

Moreover, Bagherpour (2007) mentioned that if the large shareholders have significant control over the firm, the conflicts of interest of the agency problem may shift from shareholder and manager to large shareholders and minority shareholders. The increased agency problem causes due to the large shareholders attempt to gain more interests under the situation of insufficient costs (Lemmon and Lins, 2003). According to this situation, the rest minority shareholders would feel necessity for acquiring high quality of audit in order to assure the interests of small shareholders. As Clessens and Fan (2002) argued that the traditional corporate governance mechanisms, such as board of directors, do not has enough power to diminish agency problem especially in an emerging market. In the study of Fan and Wong (2005) indicated a positive relationship between the agency conflicts especially among large and small shareholders and the auditor selection based on the audit quality in the emerging markets. As the increased in the level of conflict, the auditor changes increased as well.

In China the listed companies usually have a big controlling proprietor, due to the high ownership concentration feature of China. The ownership structures could have

impact on corporate governance and corporate value in different way. When the large controlling shareholders attempt to bypass the monitoring of other shareholders to have big control on company affairs, the agency costs would be higher (Johnson et al., 2000). Moreover, Porta et al. (2002) argued that there is increased agency problem in the large corporations around the world due to the large controlling shareholders deprive minority shareholders of interests through aggressive "tunnelling" behaviours. Same as Lin and Liu (2009) mentioned that in China context, on average, controlling shareholders of China listed companies always hold most of the equity.

In China listed companies, the large controlling shareholders usually attempt to avoid firms being monitored by high quality auditors so as to maximize their interests. Lin et al., (2007) stated that the higher level of ownership concentration, the weaker internal corporate governance mechanism and the more opacity earnings will be. Hence, the listed firms with large controlling owners would be more likely to change auditors in order to protect their private benefits.

Lin and Liu (2009) explored the reasons of auditor switching, the study conducted through the channel of internal corporate governance. The data of this research were collected from Taiwan Economic Journal database, China Stock Market and Accounting Research database with a sample of 182 companies from different industries. There are 91 companies which switched auditors from year 2001 to 2004. This study shows that in a firm the controlling shareholders hold a greater proportion of total number of shares would be more likely to switch auditor.

Moreover, another study by Ming (2007) examined the relationship between firms' internal corporate governance mechanism and auditor choice. This study used sample of 1387 listed firms from both Shanghai and Shenzhen Stock Exchanges. The researcher collected data from China Stock Market and Accounting Research Financial Database and Initial Public Offering Research Database from 2001 to 2004. The finding shows that there is a significant relationship between firms' internal corporate governance mechanism and auditor switches. In the same way, the largest controlling shareholders are significantly related to auditor switch.

Furthermore, Bagherpour (2007) examined the causal factors of auditor switches in Iran and it explored the relationship between concentration variable and auditor switching. The data were collected form TSE library with the sample of 748 firms from 1999 to 2003. The result shows an inconsistent result from prior studies where ownership concentration is insignificantly associated with auditor switch.

2.2.4 Leverage

According to Bahman and Elnaz (2012) financial leverage represents the financial risk of a firm. The financial leverage of a firm is measured by dividing the total liabilities by its total assets. Prior studies have investigated the relationship between leverage and auditor switches. This study indicates that leverage is positively related with selection of large audit firm, and it's supported by U.S. studies (eg. Francis and Wilson, 1988; Defond, 1992; Reed et al., 2000). A study conducted in New Zealand

by Firth and Smith (1992), study of East Asian countries such as Singapore by Fan and Wong (2005), also support this result. However, still some researches fail to support this relationship, such as studies conducted in Europe such as, Sundgren (1998), Citron and Manalis (2001), and Piot (2001). Nonetheless, the study by Choi and Wong (2005) found the significant positive relationship in four different European countries which are Norway, Spain, Sweden, and the UK, however this study found a negative relationship in Germany and Portugal. Moreover, Hay and Davis (2004) found no significant result. Thus, it can be said that the association between leverage and auditor switch is different among various countries (Piot, 2001; Sundgren, 1998).

Bagherpour (2007) suggested that the increasing in debts will result increasing in interest conflicts between shareholders and debtholders. Meanwhile, as the increase in debts, the agency costs which associated with the conflicts of interest between shareholders and debtholders will also increase, particularly in the case of risk transferring incentive. The risk transferring can be regarded as that the increases of level of debt, there would be an increased incentive for shareholders to take higher risk project, because that if the high risk project is completed successfully the shareholders will be benefited from taking this riskier projects and remain the residual gain, however they only need to pay debtholders the contracted rate. Whereas the debtholders may suffer the costs of the high risk project if the project is not successful (Bathala et al., 1994).

Regarding to the national conditions of China, after the mushrooming Sino-foreign joint ventures and the adoption of the "open-door" policy in China in the early 1980s, there was an increased new risk between the private shareholders and debtholders that transferring wealth from debtholders to shareholders (particularly for the big shareholders), thus there is also an increased conflicts of interest. Because that before the new policy adopted in China, the ever existed lower risk of wealth shifting from debt holders to shareholders due to the state ownership feature and the state control over companies and banks (debt holders). Moreover, regarding to the existence issue of high ownership and the large shareholders' influence on managers in China listed companies, the managers of listed companies would have more incentives to transfer wealth from the debt holders to the shareholders. Thus, due to the high level of interest conflicts between majority shareholders and debt holders and high level of incentives of management for wealth transferring, the debtholders may increase the desire to require high quality of audit in order to protect debt holders' interests in such emerging market.

Moreover, Jensen and Meckling (1976) has stated in the prior study that it has raised concerns to the debtholders that the possibility of wealth transferring from debtholders to shareholders by managers, in order to maximise managers' interests because managers are working for the shareholders. Jesen and Meckling (1976) also mentioned that as the increases in amount of debt, the possibility of wealth transfer will increase as well. Hence, as the leverage increases, the demand for high audit quality will also increase (Defood, 1992; Woo and Koh, 2011) due to that auditing is considered as an efficient way to reduce agency costs, such as the agency costs of interests conflicts between shareholder and debtholder.

Thus, it can be said that there is a positive correlation between leverage and shareholder or the wealth transferring from debtholder by high incentive managers (Jensen and Meckling, 1976; Watts,1977; Chow,1982). Accordingly, the agency costs of the conflict of interests between shareholder and bondholder could be influenced by the percentage of debt of firms, and the company's capital structure may be changed at different times thus the costs of interest conflicts during the different period could be different as well (Chow,1982). Therefore, this indicates that different level of audit quality depends on the different level of agency costs, any changes in agency costs including changes in company debts could lead to auditor switches. This is also consistent with prior studies (Watts, 1977).

Aksu, Onder, and Saatcioglu (2007) argued that the percentage of debt in the capital structure will lead to increase in the agency cost. Thus, the demand for an independent auditing will increase as well. This has been supported in the early studies, such as Chow (1982) examined the effects of leverage on the demand for high quality audits, and other studies (eg. DeFond, 1992; Firth and Smith, 1992). The results of those studies show that there is a positive relationship between leverage and demand for high quality auditors. Furthermore, Johnson and Lys (1990) found the positive association between high leverage and ability of large audit firm to diversify away the risk. Some studies found the negative relationship between the leverage and brand name reputation auditors (Simunic and Stein, 1987 and Fransic and Wilson 1988). This is supported by Johnson and Lys (1990), this study indicated

that firms with high level of debt would be more likely to switch to lower quality auditors.

Aksu et al., (2007) investigated the auditor choice and client firm characteristics in the samples of Istanbul Stock Exchange listed firms. They stated that firms in Turkey still prefer high leverage even though the high cost of borrowing in Turkey, because of the tax benefits and hyperinflation firms believe that it advantageous to be a net barrower. On the demand side, the firms with high level of leverage would like to seek for a lenient auditor to get a clean audit opinion. On the supply side, the audit risk might increase because of leverage, and it would affect choice of audit firm to be the auditor of such a financially distressed client. The higher brand name reputation auditors might refrain from being auditors of those higher audit risks clents.

In the study of Cullinan and Du (2012) argued that leverage can be considered from two perspectives, which are clients demand or auditors supply perspective. From clients demand perspective, clients with high level of financial leverage are willing to look for auditor with good brand reputation in order to increase the credibility to their creditors. Form the auditor supply perspective, due to the clients with high level of leverage could indicate high level of financial risk, therefore, auditors are less likely to accept clients with those riskier clients.

Bahman and Elnaz (2012) identified the factors affecting auditor selection in Tehran listed companies. This study used logistic regression, the factors such as size of client

firm, audit report, ownership structure, profitability, and leverage are examined. However, the results find insignificant relationship between leverage and auditor selection.

Broye and Weill (2008) investigated the relationship between leverage and auditor choice through examining the impact of legal environment. This study investigated auditor choice among small and medium size companies, the sample selected from 10 European countries. The results indicate that leveraged firms in countries with more effective laws in protecting creditors' rights are willing to select big audit firms as the auditors.

2.2.5 Big audit firm

According to DeAngelo (1981) it is difficult to measure and observe audit quality in a directly way. Audit quality is used to explain the auditor's ability to disclose irregularities or report errors in the firms' published financial reports. However, the audit quality usually depends on the characteristic of auditors, such as, auditor independence and auditors' technical competence. The big audit firms usually have less incentive to act opportunistic because of the importance of reputation in the audit market, meanwhile they refuse to suffer any potential lose due to audit failure (Pittman and Fortin, 2004). Thus, DeAngelo (1981) stated that the size of audit firm can be an important element to measure audit quality, because reputable auditors have greater incentives to provide high quality audit to the clients in order to maintain economic rents and avoid any unexpected loss. Consistent with this point of

view, several researchers (Simunic, 1980; Beatty, 1986; Firth and Smith, 1992; DeFond, 1992) argued that audits as products that can be differentiated based on the quality of audit, while the big audit firms are expected to produce higher quality audits. Many study used big audit firms (such as Big Five or Big Four) as a proxy of audit quality (eg. Moizer, 1997).

Study by Krishnan and Schauer (2000) investigated the association between size of audit firm and audit quality, this study used non profit companies as the sample. The findings show that size of audit firm are positively associated with audit quality, with the moves from the small audit firm to the big six the noncompliance with standards will decrease.

Likewise, other studies such as Francis and Krishna (1999), Menom (2003), Lee et al. (2004), and Carey and Sinnett (2006) argued that audit quality could be considered to be associated with the size of audit firm, because large auditors are always predicted to be more independent and have more professional expertise so that they can provide higher level quality of audit services comparing to others.

Some empirical researches mentioned that big N auditors can detect earnings management prepared by managements more effectively via using accounting accruals in order to assure the reliability of financial reports (Francis and Krishna, 1999;Balsam et al., 2003; Watkins et al., 2004).

Study by Francis (2004) found that clients usually select big four auditors for acquiring better assurance services. Zhang et al., (2010) stated that client firms audited by small and poor quality audit firms usually have less disclosure transparency. The result is consistent with the study of Zhang et al., (2010) that those firms with less disclosure transparency are prefer to select small and poor quality audit firms. Moreover, the client firms, whose largest shareholders are political people, usually choose auditors from the small audit firms.

In the study of Guedhami et al., (2009) investigated the auditor choice in the private firms that after privatization of government firms among 32 countries. The study indicates that firms after privatization have less demand for big four. They also argued that the countries with poor corporate governance have low demands for big audit firms.

Moreover, Broye and Weill (2008) found that the countries particularly in European countries with more effective laws in protecting creditors' rights, the leveraged firms will prefer to select big audit firms. The findings are similar with the research by Choi and Wong (2002) that auditor selections are associated with national legal environments. The finding shows that the in stronger legal enforcement law countries, they usually require high quality auditors (big audit firm) who can provide high quality of audit services.

Some studies measure audit quality depends on whether auditor issue going concern opinions. According to the study of Gieger and Rama (2006) there is no significant difference in quality of audit service between different size of audit firm (such as big4 or nonbig 4), however, Boone et al. (2010) shows that the auditors of big 4 are more likely to issue going concern opinion than other audit firms (non big 4).

Cullinan and Du (2012) used a model to examine the realignment between auditor and client when clients change auditors from big4 to non big 4 firms, both client-demand factors and auditor-supply factors were discussed in their study. Landsman (2009) and Knechel (2008) found that clients with a large size have a higher tendency to select big 4, likewise clients with higher asset turnover have higher tendency to select larger audit firms (Sourza, 2004), due to the reasons of that larger size of clients need greater available resources and empirical expertise to perform the audit compare to small audit firms. Similarly, the clients with overseas operation also desire big audit firms to provide available and sufficient knowledge to perform auditing in foreign countries (Bedard et al., 2000).

Researches such as Chaney (2004) and Hay and Davis (2002) found that clients with high level of leverage are more likely to choose big audit firms, because they are perceived that clients audited by large audit firms can ensure the credibility of the financial statements in order to extend credit from their lender. Moreover, non big four audit firms would be less likely to engage in clients with higher level of financial risk due to higher risk clients usually have higher likelihood of failure

which may result negative impact to the reputation of small audit firms that even they have not gained (Lawrence et al., 2011).

However, Suyono, Yi, and Riswan (2013) found an insignificant relationship between size of audit firm and auditor switching.

2.3 Theories related to auditor switch

2.3.1 Agency theory

Agency theory could be described as the most widely used theory to explain auditor switches (Nazri et al., 2012). Agency theory attempts to explain the relation of the principal and the agent and the duties of both parties. An agency relationship is explained as one or more principals (owners) engage another person as their agent to carry out a task on the principals' behalf (Watts and Zimmerman, 1986). The purpose of this theory is to resolve the conflict of interest and risk sharing issues (Eisenhardt, 1989).

According to the literature, the agency theory has been expanded to two basic theory which are positive agency theory and principal agent theory to explain the same problem (Jensen, 1983). The positivist research has highlighted conflict of interest between manager and owner especially in the public firms (Eisenhardt, 1989). While, the principal agent theory describes the relationship between agent and principal

which can be adopted in the model of the buyer-supplier, employer-employee and other agency relationships (Jensen, 1983).

Moreover, According to the literature in the early researches, agency theory has been employed in a wide field, such as in advertising field (Aish, Kortam and Hassan, 2008), in computing field (Gurbaxani and Kemerer, 1989), in supply management and marketing areas (Tate et al., 2009) and so on.

The principal agent theory in auditing usually describes the relationship between auditors and management. Auditors are seen as the agent and required to provide assurance services in checking on the managements' performance and to mitigate the agency problem (Fan and Wang, 2005). As auditor plays agent role, there could be a conflict of interest between fulfilling the managements' own demand or keeping independence characteristic or professional norms, this may lead to auditor switches eventually.

Watts and Zimmerman (1983) states that the conflict of interests between different parties, such as managers- shareholders, majority-minority shareholders, and both shareholders and lenders could increase the agency risks, while the efficient way to mitigate this conflict is via auditing. According to Jencen and Meckling (1972) that clients decide to switch auditors main because of the principle-agent problem in risk sharing, ownership and control separation, and decision making or control function of a firm. The larger shareholders may take advantage on the control of the firm

based for their own interest which may conflict with the interest of small shareholders (Zhang, Cheng and Ren, 2013). Thus, the majority shareholders may prefer to create audit collusion phenomena with their satisfied auditors in order to fulfil the demand of larger shareholders (Chen, 2007). Accordingly, Jensen and Meckling (1979) and Jensen and Fama (1983) argued that auditor switches can be the result of interest conflict between principal and agent. Therefore, in the principal-agent relationship of agency theory, there is increased need for independent audit.

2.3.2 Signaling theory

Signalling theory was originally proposed by Spence (1973) to explain job market behaviour (Cullinan, Wang, Yang and Zhang, 2011). This theory is used to explain the behaviour when the two parities getting different information (Connelly, Certo, Ireland and Reutzel, 2011). Many accounting and auditing studies have employed signaling theory, for example, management may signal firm's financial status to the investors through financial information disclosure, thus this financial disclosure can be the signal by investors (Mavlanova, Benbunan and Koufaris, 2012).

Many past studies used signalling theory to explain the reasons of why the clients switch auditors. Signalling theory states that clients switching auditors depend on if the auditor they engaged could satisfy the needs of clients that convey or signal the reliability or quality of the financial information to the public (Bagherpour, Monroe and Greg, 2010).

2.4 Research framework

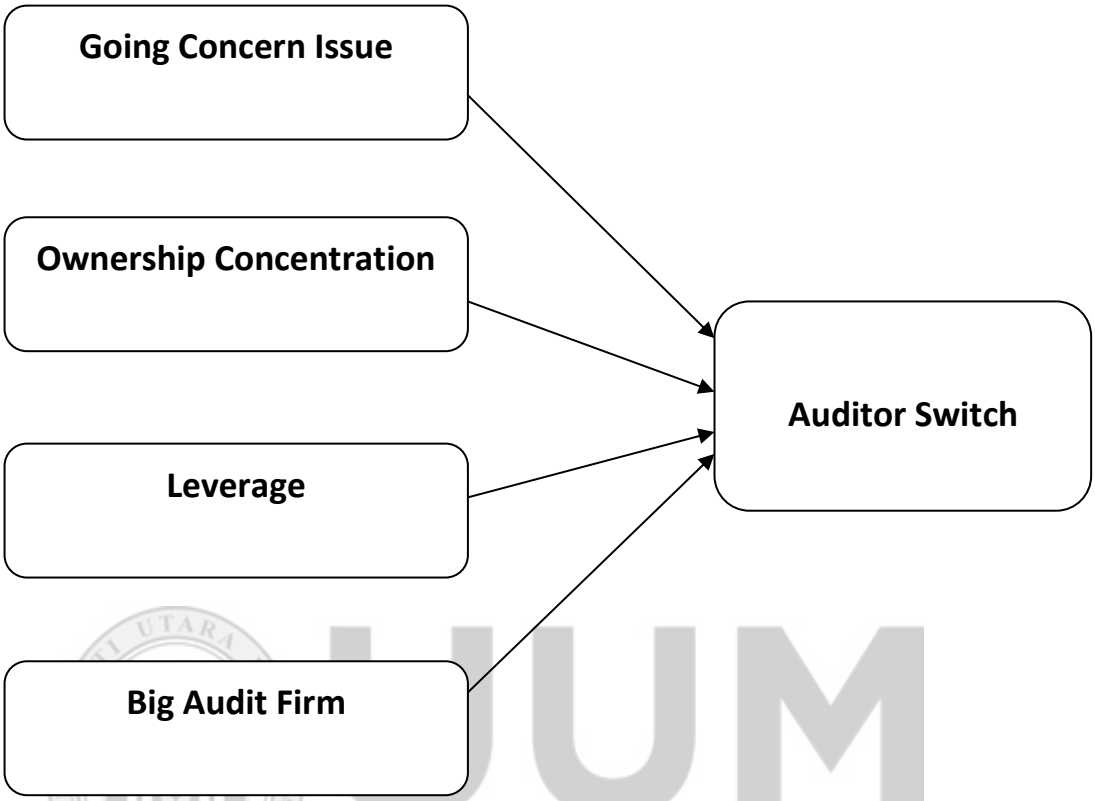

Figure 2.1 Research Framework

The research framework is exhibited in the figure 2.1, the dependent variable of this study is auditor switch. There are four independent variables in this study, which are going concern issue, ownership concentration, leverage, and big audit firm.

2.5 Hypotheses development

Based on the prior empirical evidences, four hypotheses of the study are developed as follow:

2.5.1 Going concern

Based on the previous empirical researches the issuance of going concern opinion has been seen as the indicator of audit quality (Badertscher et al., 2012), and according to the literature, the issuance of going concern opinions by auditors may generate weakly negative consequence to the firm. However, the result of negative market returns may be mixed with the going concern opinion issuance and other information that released at the same time (Keller and Davidson, 1983; Menon and Williams, 2010). Nonetheless, prior studies have shown that the if firms receive a going concern opinion, it could increase the cost of capital of the company (Amin et al., 2014), and the firms receiving going concern opinions seems to increase the likelihood of failure than those who did not receive going concern opinion (Garsombke and Choi, 1992). Accordingly, firms are unwilling to receive a going concern opinion from auditors and if possible they may have significant reason to avoid receiving going concern opinion (Bowler, 2015).

Research consistently shows that clients may decide to switch auditors as a result to avoid receiving a going concern opinion (Geiger et al., 1998; Lennox, 2000; Vanstraelen, 2003; Chan et al., 2006). There are also some researches show the similar results that issuance of going concern opinion will result in increasing on

auditor switching (Krishnan 1994; Krishnan and Stephens, 1995; Carcello and Neal, 2003). Thus, H1 is expected as follow:

H1: There is a significant relationship between going concern issue and auditor switching.

2.5.2 Ownership concentration

The controlling shareholders always have a large control over managers and hold control excess of the their original rights, which may potentially extract private benefits at the cost of minority shareholders (La Porta et al., 1999). Because those large shareholders have rights to maximize their own welfare which only represents their own interests but may not coincide with the interests of other minority shareholders (Shleifer and Vishny, 1997). Thus, auditor switches are more likely to occur in order to protect the benefits of large shareholders.

Darmadi (2012) investigated the influence of ownership concentration on the demands for high quality audits. This study used sample of 787 firms on Indonesia Stock Exchange and logistic regression model is employed in his study. The evidence of this study is that firms with higher ownership concentration are more likely to switch to big 4 auditors. Moreover, the study also show that when the firm is a family controlled firm, imply that controlling shareholder is a family, there would be a negative relationship between ownership concentration and high quality auditor, due to family controlled firm have high tendency to sustain opaqueness gains through auditing by low quality auditors.

Study by Lin and Liu (2009) used regression model examined corporate governance in China on auditor switching; they found that larger controlling owners are more likely to switch auditors to small audit firms. This result is consistent with Cleaessens and Fan (2002), Lin et al. (2007), Ming (2007).

Thus H2 can be stated as follow:

H2: There is a significant relationship between ownership concentration and auditor switching.

2.5.3 Leverage

Leverage has been seen as a useful tool for reducing the agency problem. The past researches have argued that financial leverage has a large impact on firm's financial performance (Jensen and Meckling, 1976). Jensen (1986) stated that high level of financial leverage could reduce agency costs and improve company's financial performance.

According to Sulong, Gardner, Hussin, Sanusi, and Mcgowan (2013) the agency problem will arise due to the increased interest conflict between shareholder and debt holders. This agency problem occurs when there is a loan agreement between the company and debt holders even the company is not performing well. Thus, the shareholders will gain incremental benefits when the company' performance is very well. Therefore, shareholders could gain more benefits than the debt holders if the company has good financial performance during this period. Accordingly, the demand for high quality of auditing will arise in order to ensure the credibility and

financial transparency and to make sure the corporate managers will not engage in fraudulent activities (Piot, 2001). As the increases in the percentage of debt, the demand for auditing will increase as well, thus may creates a high demand for higher quality audits (Palmrose, 1984). Therefore, this will lead to auditor switching.

Eichenseher and Shields (1989) and Defond (1992) found that financial leverage is related to the choice of big 8 auditors. Ismail, Aliahmed, Nassir and Hamid (2008) investigated the determinants of auditor change in Malaysia, Logistic regression is used in their study. The results show that leverage is positively associated with auditor change.

Furthermore, other prior studies have examined the relationship between leverage and auditor switches, they found that leverage is significantly associated with auditor switches (Fransic and Wilson, 1988; Citron and Manalis ,2001; Woo and Koh, 2001; Ismail et al., 2008).

The H3 is expected as follow:

H3: There is a significant relationship between leverage and auditor switching.

2.5.4 Big audit firm

Size of audit firm has been seen as a crucial factor that related to auditors' independence characteristic. Mautz and Sharaf (1961) mentioned that auditors of small audit firms are more likely to be dependent on clients for gaining more benefits and making big contribution to the firm's total revenue. It implies that small size of audit firms have a high tendency to have a close relationship with client which may impair their independence characteristic of auditors. The study by Weiner (2012) examined company switch auditor decisions following corporate fraud. The study found that many companies are willing to switch to big audit firms. Because that in many researches, they predicted that big audit firm represent good audit quality, such as, DeAngelo (1981), Moizer (1997), Krishnan and Schauer (2000), Lennox (2005), and Carey and Sinnett (2006).

According to Willenborg (1999) the clients especially with a large size will be more likely to switch to a larger audit firm due to the big firm always represent good quality and auditors with more expertise.

Shockley (1981) states that audit firm in the high competitive auditing environment the small audit firm would suffer a greater risk and more likely losing independence characteristics. This point of view is consistent with Bakar et al. (2005).

Thevenot and Hall (2009) examined determinants of auditor change in the US, the findings show that big audit firm's auditor is one of the determinants of auditor

change in this study. Kadir (1993) found that reputation of audit firm is significantly associated with auditor switching. Therefore, H4 is expected as follow:

H4: There is a significant relationship between big audit firm and auditor switching.

2.6 Conclusion

This chapter provides a deep evaluation on the factors influencing auditor switching on the basis of literature reviews. The determinants of auditor switching have been discussed in details, which are going concern issue, ownership concentration, leverage, and big audit firm. This chapter also reviewed two theories, which are agency theory and signalling theory, theses two theories provides good discussions to explain the main reasons for auditor switching by firms. Based on the reviewed literature and results of previous empirical researches, four hypotheses have been developed. The research methodology of this study will be discussed in the next chapter.

CHAPTER THREE

METHODOLOGY

3.1 Introduction

This chapter discusses how the study is being carried out. This chapter provides a clearly plan of this research, all the method used to get the results of the study are exhibited. Furthermore, Research design, sample and sampling technique, research instruments, source of data, data processing and research model are discussed this in chapter.

3.2 Research design

There are many factors that affecting auditor switching. In order to determine the main factors which influencing auditor switches, the quantitative method will be adopted to examine the determinants that affect auditor switching among A-share listed companies in Shanghai Stock Exchange. A descriptive and explanatory research is conducted to describe the characteristics of the factors which affect auditor switches in China context, and to explain the causal relationships between auditor switches and each independent variables. There are two forms of reasoning used in the previous research, deductive reasoning and inductive reasoning. This study will use deductive reasoning to collect and analyze the secondary data to develop theoretical propositions and tests them in order to generate empirical evidence. The dependent variable in this study is auditor switch; the independent

variables are going concern issues, ownership concentration, leverage and big audit firm.

3.3 Sample and sampling technique

Based on the population of 863 A-share listed companies in Shanghai Stock Exchange, the sample of this research consists of 182 companies in three years (2012-2014), and every 61 companies will be selected from each year of total three years. Allowance for missing or incomplete data will be taken into consideration for data analysis purposes.

The simple random sampling is applied in this research to select samples from the population of all listed company in A-share listed companies in Shanghai Stock Exchange.

3.4 Research Instrument

The research instrument in this study is annual report. The annual reports of A-share listed companies are downloaded from Shanghai Stock Exchange website. Then Microsoft Excel is used for recording and entering the data of this study. After that the secondary raw data will be imported into STATA 13.0 software to conduct a series of analysis test.

3.5 Source of data

This study uses secondary data as the source of data to investigate the relationship between each variable. Densombe (2007) mentioned that secondary data could offer obtainable and comparable data which may not available in primary data.

3.6 Data processing

Cross-sectional data will be used in this study. Cross-sectional data can be defined as a type of data collected by observing many variables at a single point in time (Brady and Johnson, 2008). The relevant data will be collected from Shanghai Stock Exchange website, annual report, annual meeting, financial statements of selected companies and notes. The data from year 2012 to 2014 will be used in this study.

3.7 Research Model

The research model of this research is based on the research framework. The Logistic Regression Model is used to examine the determinants of auditor switching. The application of this model is similar to the past researches (e.g. Vanstrealen, 2003; Black, Burton and Maggina, 2012; Khasanah and Nahumury, 2013). Logistic regression analysis is employed in this study because the dependent variable of this research is dichotomous (switch auditor or do not switch). Moreover, the logistic regression model is usually used to predict a dependent variable on the basis of independent variables and to determine the percentage of variance in the dependent variable explained by the independent variable (Imam, 2011).

According to Imam (2011) logistic regression transfers the dependent into a logit variable (the natural log of the odds of the dependent variable occurring or not). Logistic regression applies the maximum likelihood estimation to predict probability of certain event occurring. Logistic regression has less stringent assumptions due to that logistic regression does not assume homoscedasticity, and it does not follow the assumption of linearity of relationship between dependent and independent variables (it implies that it applies a non-linear log transformation to predict odds ratios). As well, it does not require the assumption of normally distribution because logistic regression does not require assumption of the normality of the data on the independent variables. Logistic regression can be heteroscedastic, in general, the independent variables in logistic regression analysis do not have to be metric, because it can handle both nominal and ordinal data on independent variables.

The research model can be stated as follow

$$ASW = \beta_0 + \beta_1 GC + \beta_2 SZ + \beta_3 OC + \beta_4 LEV + \varepsilon$$

ASW= auditor switch (1,0) that a firm did (1) or did not (0) switch auditors.

GC= going concern issue (1,0) that a firm face (1) or not face (0) going concern issue.

OC= ownership concentration, measured by the ratio scale, the percentage of total shares held by largest shareholder.

LEV= leverage, measured by debt ratio, total debt to total assets.

Big4= Big audit firm (1,0) that a firm audited by the big accounting firm including big4 international and local big4 (1) or audited by non big accounting firm (0).

3.8 Conclusion

This chapter discusses the methodologies used in this research. In this chapter the research design and research model are highlighted. Aside from that, sample and sampling technique, research instruments, data source, and data processing are presented. This research further presents the research framework on the basis of variables related to auditor switching. The research analysis generated outcomes will be further presented and explained in the following chapter on the basis of the research methodology.

CHAPTER FOUR

RESULTS

4.1 Introduction

The previous chapters describe the research method used to examine the determinants of auditor switch. This chapter presents the results of data analysis regarding to each variables. This analysis results seek to answer the research questions based on the research objectives which are proposed in the early chapter. In this chapter, descriptive statistics, correlation analysis and logistic regression analysis are conducted by using software of STATA version 13. Thus, this chapter is organized as follows, section 4.2 discusses the results of descriptive analysis, followed by correlation analysis and logistic regression in section 4.3 and 4.4 respectively. Then, this chapter is end with brief summary of this fourth chapter, further discussions are discussed in the last chapter of this study.

4.2 Descriptive Analysis

Table 4.1 exhibits results of descriptive analysis of each variables which including dependent variable the auditor switch and independent variables, which are going concern, ownership concentration, leverage and big audit firm. Table 4.1 shows the summary statistics for the full sample of this study, in which mean standard deviation, minimum and maximum value are tabled.

Table 4.1

Results of descriptive statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
Auditor switch	182	.5054	.5013	0	1
Going concern issue	182	.1868	.3908	0	1
Ownership concentration	182	.3707	.1794	.0395	.9226
leverage	182	.5921	.3440	.0496	4.0259
Big audit firm	182	.1483	.3564	0	1

Auditor switch as a dummy variable, it can be coded 1 if the company switched auditor; otherwise, it is coded as 0 if there is no auditor switches. The information in table 4.1 shows that in the sample of 182 listed companies, the mean value of auditor switch is .5054 with standard deviation of .5013. The minimum value of 0 and maximum value of 1 represent whether firms switched their auditor.

For the independent variable, going concern issue, it is measured by nominal scale, labelled 1 if firm face going concern issue at time of separation, it is equal to 0 if the firm does not exist going concern issue. Then, mean value of going concern variable is .1868 with standard deviation of .3908. The minimum value of going concern is 0, the maximum value is 1.

The results present that the mean value of ownership concentration is .3707 with the value of standard deviation of .1794. The independent variable of ownership

concentration is measured by the percentage of total shares hold by the largest shareholders. The minimum value of this independent variable is .0395, it means that in the full sample of 182 listed companies, the lowest percentage hold by the largest shareholders is 3.95%. While, the maximum value of ownership concentration is .9226, implies that the largest percentage of shares hold by the largest shareholders in the full sample of 182 listed companies is 92.26%.

With regards to independent variable of leverage, it is measured by the debt ratio (total debt to total assets). The mean value of leverage is .5921. The value of standard deviation is .3440. The minimum value is .0496 and the maximum value of leverage is 4.0259.

According to the results of descriptive statistics shows in table 4.1, the mean value of big audit firm is .1483 with the standard deviation of .3564. The independent variable of big audit firm is measured by normal scale, it is labelled 1 if the audit firm audit by the big audit firm, coded 0 otherwise.

4.3 Correlation analysis

Correlation analysis is used to investigate the relationship between dependent variable and independent variables. It is important to use correlation analysis in this study to test the intercorrelation between each variable. Because the research model of logistic regression, it does not follow the assumption of linearity of relationship

between each variable. Moreover, correlation analysis describes the strength of the linear relationship between each variable of the study.

The correlation analysis can be used to measure the relationship between two or more variables that whether there is a significant relationship exists among variables and the symbol r represents the correlations are either positive or negative. The strength of relationship between each variable depends on the coefficient scale, ranging from -1 to +1. If the correlation is -1, it implies that there is a perfect negative relationship between variables. Otherwise, if the correlation is +1 indicates that there is a perfect positive relationship.

Table 4.2

Correlation analysis

	Auditor switch	**Going concern**	**Ownership concentration**	**leverage**	**Bigaudit firm**
Auditor switch	1.0000				
Going concern	-0.0053	1.0000			
Ownership concentration	-0.0447	-0.3532*	1.0000		
leverage	0.1253	0.4044*	-0.1503*	1.0000	
Big audit firm	-0.2674*	-0.0811	-0.0249	-0.1399	1.0000

*. Correlation is significant at the 0.05 level

As the results show in table 4.2 above, going concern issue is negatively related to auditor switch. The correlation coefficient between going concern and auditor switch

is r=-0.0053 (0.53%), implies that the relationship between going concern and auditor switch is quite weak. The correlation coefficient between ownership concentration and auditor switch is -0.0447 (4.47%), it shows that there is weak and negative correlation between ownership concentration and auditor switching. The table results show a positive correlation between leverage and auditor switch at the coefficient of 0.1253(12.53%), it indicates that the correlation between leverage and auditor switch is weak. Table 4.2 shows that the correlation between big audit firm and auditor switch is -0.2674* (26.74%), implies that the relationship between big audit firm and auditor switch is negative, and the correlation between auditor switching and big audit firm is significant at the 0.05 level.

Table 4.2 above shows that there is negative relationship between ownership concentration and going concern at a coefficient of -0.3532 (35.32), and the correlation between ownership concentration and going concern is significant at the 0.05 level. The correlation between going concern and leverage is 0.4044* (40.44%) implies that the relationship between going concern and leverage is positive and significant at the 0.05 level. In the same manner the correlation coefficient between going concern and big audit firm is -0.0811 (8.11%), it shows a negative and weak correlation between going concern and big audit firm. Similarly, ownership concentration and auditor switch has a negative and significant correlation at a coefficient of -0.1503 (15.03%). Further, there is negative and weak correlation between big audit firm and ownership concentration, and negatively weak correlation between big audit firm and leverage, at coefficient of -0.0249 (2.49%), and -0.1399 (13.99%) respectively.

4.4 Logistic Regression

Logistic regression is used to examine the relationship between dependent variable and independent variables when the dependent variable is binary or dichotomous. In this study, logistic regression model is adopted because the dependent variable, auditor switch is dichotomous that auditor switch or not.

The logistic regression model is shown as follow,

$$ADTCG = \beta_0 + \beta_1 GC + \beta_2 OC + \beta_3 LEV + \beta_4 BIG4 + \varepsilon$$

ADTCG = auditor switch (1,0). It is coded '1' if firm switch auditor, coded '0' if firm did not switch auditor.

GC = going concern issue (1,0) Equals '1' if a firm face going concern issue, equals '0' if firm did not face going concern issue.

OC = ownership concentration, it is measured by the ratio scale, the percentage of shares held by the largest shareholder of the firm.

LEV = leverage, it is measured by debt ratio, total debt to total assets.

Big4 = big audit firm (1,0), it is coded '1' if the firm audit by big audit firm including big 4 international accounting firm and local big4 accounting firm of China, it is coded '0' if the firm did not audit by big audit firms. Table4.3 below presents the results of logistic regression,

Table 4.3

Results of logistic regression

Logistic regression	Number of obs	=	182
	LR chi2(4)	=	17.44
	Prob > chi2	=	0.0016
Log likelihood = -117.42031	Pseudo R2	=	0.0691

Auditor switch	**Coef.**	**Std. Err.**	**z**	**P>z**
Going concern issue	-0.5939	0.4710	-1.26	0.207
Ownership concentration	-0.8544	0.9273	-0.92	0.357
Leverage	0.9815	0.6928	1.42	0.157
Big audit firm	-1.6871	0.5288	-3.19	0.001
_cons	0.0952	0.5481	0.17	0.862

As table 4.3 shown that the P value of the correlation between auditor switch and going concern is .207, means that there is no significant relationship between auditor switch and going concern issue, which inconsistent with the results of Chen, Gupta and Senteney (2004) and Calderon and Ofobike (2008). Thus, this result of going concern does not support H1, which stated that there is a significant relationship between going concern issue and auditor switch.

Based on the result of logistic regression model, the association between independent variable of ownership concentration and auditor switch is found to be not significant,

due to the p-value of ownership concentration is .357. This results reject H2 assumed that there is a significant relationship between ownership concentration and auditor switch. Further, the finding does not support previous results that ownership concentration is significantly related to auditor switching (such as, Cleaessens and Fan, 2002; Ming, 2007; Lin and Liu, 2009). However, the result is consistent with the finding of Bagherpour (2007) that ownership concentration is insignificant factor towards auditor switching.

Table 4.3 shows that the P-value of leverage is .157, it indicates that there is an insignificant relationship between leverage and auditor switch. The H3 supposed that there is a significant relationship between leverage and auditor switch. Thus, the finding rejects H3. This finding is consistent with the studies of Hay and Davis (2004), and Bahman and Elnaz (2012). But some studies do not support this result, such as Fransic and Wilson (1988), Citron and Manalis (2001), and Woo and Koh (2001).

The result of this study indicates that the p-value of big audit firm is .001, it implies that there is a significant association between big audit firm and auditor switch. Moreover, based on the coefficient of -1.6871, it means that the big audit firm is negatively associated with auditor switching. Therefore, this finding supports H4 that there is a significant relationship between big audit firm and auditor switch. The finding is supported by the research of Kadir (1993), Thevenot and Hall (2009).

4.5 Conclusion

This chapter presents results of descriptive analysis and correlation analysis followed by the logistic regression model to investigate the determinants of auditor switching in China context, in order to achieve the objectives of this study and in turns to answer the questions of this research. A total sample of 182 companies is selected from Shanghai A-share listed companies from the period of year 2012 to 2014. In this study there are four independent variables are predicted to associate with auditor switching. However, based on the logistic regression model, the findings show that going concern issue, ownership concentration, and leverage have insignificant relationship with auditor switching. While, the results indicate that there is a significant association between big audit firm and auditor switch. The finding shows that big audit firm is negatively and significantly related to auditor switching. The next chapter provides further discussions.

CHAPTER FIVE

DISCUSSION, CONCLUSION, AND RECOMMENDATIONS

5.1 Introduction

After analyzing the results, this chapter presents the discussion and summary of this study, and the conclusion of the analysis results based on research questions and hypothesis. Implications and recommendations for future researches are discussed as well.

5.2 Summary of the study

The purpose of this study is to identify the factors that influence auditor switching in China context, and to examine the relationship between determinants and auditor switching. The major factors which have been examined in this study are going concern issue, ownership concentration, leverage, and big audit firm. The samples of this study are 182 listed companies selected from Shanghai A-share stock Exchange. Logistic regression model is employed to test hypotheses. Furthermore, this study also conducted descriptive analysis and correlation analysis.

Based on the results of logistic regression, the findings fulfilled objectives of this study, and provides answers to the research questions and hypotheses. Research questions and hypotheses compared with results of study are shown below:

1. Is there a relationship between going concern issue and auditor switching?

   The first question aims to investigate the relationship between going concern and auditor switch, thus, it aligned with the H1 which stated that there is a significant relationship between going concern issue and auditor switching. However, the results show that the association between going concern issue and auditor switch is insignificant. Thereby, this result does not support H1. This finding is inconsistent with the results of Chen, Gupta and Senteney (2004) and Calderon and Ofobike (2008).

2. Is there a relationship between ownership concentration and auditor switching?

   The second question is to investigate the relationship between ownership concentration and auditor switching. Accordingly, H2 supposed as there is a significant relationship between ownership concentration and auditor switching. The results indicate that there is no significant relationship between ownership concentration and auditor switching. Bagherpour (2007) generated a similar result that ownership concentration is insignificant factor to auditor switch.

3. Is there a relationship between leverage and auditor switching?

   The third question aims to examine the relationship between leverage and auditor switching. H3 assumed that there is a significant relationship between

leverage and auditor switching. However, the result does not support H3, means that there is an insignificant association between leverage and auditor switching. This finding is consistent with the results of Hay and Davis (2004), and Bahman and Elnaz (2012).

4. Is there a relationship between big audit firm and auditor switching?

   Similarly, the fourth question aims to investigate the relationship between big audit firm and auditor switching. Accordingly, H4 stated that there is a significant relationship between big audit firm and auditor switch. Based on the results of logistic regression model, the finding indicates that big audit firm is significantly and negatively associated with auditor switch. Thus, the finding supports H4. The finding is also supported by the research of Kadir (1993), Thevenot and Hall (2009).

In summary, the results of this study show that only H4 is supported, while H1, H2, and H3 are rejected. It implies that the results of this study might be inconsistent with some previous studies. Because that the prior studies have been conducted in different countries with different culture which may differ from China context. According to Woo and Koh (2001) that auditor switch is affected by different factors regarding to particular country's context. Thus, those results generated in different country context may not suitable and appropriate to China context.

5.3 Implication of the study

This study has examined the determinants of auditor switching in China context by using the sample of 182 A-share listed companies in Shanghai Stock Exchange.

More than that, through investigating the relationship between determinants of auditor switching, the results could provide invaluable insight to the management of firms, investors, government, and such auditing and accounting bodies in order to deal with potential issues of auditor switching in the future. Some research found that auditor switching implies that company need to select and familiarize a new auditor, so that it could be costly in terms of finance and managerial time (eg. Hennes, Leone, and Miller, 2010), thus, it also could enlighten management or firms on preventing the problem of auditor switching in the early stage. In the same way, this research could increase the concerns of both public and private sectors on the issues of auditor switching in order to minimize the possibility of auditor switching. Furthermore, it also provides additional evidence on auditor switching to literature. Meanwhile, auditor switching could compromise audit quality and auditor independence to some extent, therefore, the study has contributions to regulators, auditing bodies or who are concerned about the implications of auditor switching, audit quality, or auditor independence. Then, this study could provide useful information to auditing or accounting bodies to concern about efficiency of audit oversight.

5.4 Limitations of the study

In this study, only four independent variables are tested, which are going concern issue, ownership concentration, leverage, and big audit firm. However, the finding shows that only big audit firm is significantly related to auditor switching in China context, it may implies that although going concern and ownership concentration are the dominant features of China and based on the high auditor switching trend in China, there are still some major determinants which may influence auditor

switching are not found yet. Moreover, even there are many empirical studies has examined determinants of auditor switching, those study were conducted in different countries with different culture which may differ from China context, therefore, the results of those studies may not appropriate and suitable for this study or China context. Thus, there is lack of research evidence that conducted in China context in order to support the findings of this study. Further, the sample of this study only consist of 182 listed companies in Shanghai A-share stock exchange, and the data only covers from year 2012 to 2014.

5.5 Recommendations to future research

Based on the findings of this study that only big audit firm is significantly associated with auditor switching, more variables which may influence auditor switching could be examined, and variables in terms of corporate governance could be selected for future research. In the same way, due to special national conditions of China, there is a necessary to investigate more dominant features of China and to conduct future research based on the unique features of China, more so, it is important to know that the past empirical results may not appropriate and suitable for researches on China context. Furthermore, future researches are recommended to extent research samples, perhaps the full population of A-share listed companies could be examined and to extend the data period. Moreover, future studies could examine the implication of auditor switching, such as implications of auditor switching on audit quality or auditor independence based on the past limited empirical results.

5.6 Conclusion

In accordance with the objectives of this study that to investigate the determinants of auditor switching in China and to examine the relationships between dependent variable of auditor switching and independent variables of going concern issue, ownership concentration, leverage, and big audit firm, this study has been accomplished. Based on the logistic regression model, the findings of this study found that big audit firm is significantly and negatively associated with auditor switching. Nevertheless, there is a necessary to conduct future research for further investigation.

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