

**A STUDY OF AUDITOR SWITCH ON THE MALAYSIAN  
LISTED FIRMS  
(AN ANALYSIS OF ITS DETERMINANTS)**

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**This dissertation is submitted in partial fulfillment of the requirements  
of Universiti Teknologi MARA for the degree of Master of Accountancy**

**December 2001**

## **ABSTRACT**

There are many possible reasons for auditor switch. This study attempts to determine the possible linkage between clients' characteristics and the decision to switch auditor of Malaysian listed firms. As reflected in the agency theory, the stewardship hypothesis is used to explain the demand for auditing. Next, the theory of auditor choice and change are derived from this hypothesis. As justified by these theories, operational variables were developed and used to empirically test the proposed relationship. This empirical analysis examines a sample of sixty experimental companies (companies that switched their auditors) and sixty control companies (companies that did not switch their auditors) from 1991 to 1998. In order to examine the characteristics surrounding the auditor switch, this study employs several financial ratios, like average acquisition of fixed assets to total assets, sales growth, total assets growth, liquidity, leverage, average return on assets and earnings per share. Other qualitative variables include management change, audit opinion and changes in audit fee. Management change and audit fees were found to be significantly associated with the decision to switch auditor. In an attempt to make a comparison between the experimental companies and the control companies, sales growth followed by EPS have recorded a marginally higher mean difference, although not statistically significant. In another attempt to compare the mean between the companies that switched to Big Five, to non Big Five and switches within the same class of audit firms, no apparent difference was found in the mean results.

## ACKNOWLEDGEMENT

With Thanks and Gratitude to the Almighty God.

I would like to take this opportunity to express my gratitude to my supervisor, Professor Sayed Nazeem Ali for his kind assistance, critics, comments and supervision throughout the preparation of this dissertation.

I am indebted with Universiti Teknologi MARA for their financial sponsorship of my study.

Special thanks goes to Professor Dr Ibrahim Kamal Abdul Rahman, Dr Asmah Abd Aziz and my Research Methodology lecturer, Associate Professor Dr Normah Hj. Omar, for their invaluable advice and guidance in this study.

Most of all, to my dear family who have been my constant source of strength and inspiration. To my beloved parents, Casimir Sikayu and \_\_\_\_\_, I couldn't thank both of you enough for all your support, love, wisdom and prayers. I would also like to dedicate this work to my wonderful husband, John Tensay Ak. Peter Raig whose love, encouragement and support gave me the strength to endure all those trying moments.

I am grateful to all the staff of KLSE, UM and UKM for their kind co-operation in supplying invaluable information in enabling me to conduct this research. Finally, I wish to express my appreciation to all my dear friends, especially to Puan Roslida Ramlee and Puan Roziani Ali who have been very supportive and helpful in giving their thoughts and comments. Once again, thank you very much.

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## CHAPTER 1

### 1.1 INTRODUCTION

This paper examines whether changes in the client's characteristics are associated with the firm's propensity to switch auditor. Why do firms switch from one auditor to another? Many studies based on various theories have addressed this question, but not one theory dominates, although several theories have been supported at least in part. DeAngelo (1981) and Gregory and Collier (1996) revealed that fee dispute with auditors was said to be the reason for switching audit firms.

In Malaysia, research conducted by Joher et al. (1998) of companies listed in the KLSE cited changes in management, expertise of audit firms and the deterioration of financial health of clients as the rationale for decision to switch auditor.

*In an attempt to explain the decision to switch auditor, this research employs a theoretical model. The stewardship hypothesis, as reflected in the agency theory literature, is first used to explain the demand for auditing. The theories of auditor choice and auditor switch are then derived from this hypothesis. As justified by these theories, operational variables are developed and used to empirically test the proposed relationship.*

The decision to switch auditors by the public listed companies have been said to be an issue of interest among investors. Auditor switch announcements are utilized by the investors to revise their expectation on the firm's performance, expected future cash flow and share price. Joher et al. (1998) quoted " *Firms experiencing consistent deterioration in performance might decide to replace incumbents with a more accommodative auditor in an attempt to evade qualified*