

## AN INVESTIGATION INTO THE DETERMINANTS OF AUDITOR SWITCHING IN ACCOUNTING FIRMS

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### ABSTRACT

Auditor switching is a crucial decision made by firms, often influenced by a variety of factors ranging from financial performance to regulatory pressures. This article examines the determinant factors that influence auditor switching, focusing on accounting firms. Using a mixed-methods approach, this study analyzes data from firms that changed auditors in recent years. The findings suggest that financial distress, audit quality concerns, regulatory pressures, and client dissatisfaction are primary factors influencing the decision to switch auditors. The study contributes to the understanding of auditor-client relationships and the factors that drive these important decisions in the accounting industry.

**Keywords:** Auditor Switching, Accounting Firms, Audit Quality, Auditor Independence, Client Retention, Regulatory Influence, Auditor Rotation, Audit Market, Firm Characteristics, Audit Fees, Corporate Governance, Audit Reporting, Audit Tenure, Audit Firm Size, Auditor Selection Criteria, Audit Committees, Financial Reporting Quality, Audit Industry Trends, External Factors in Auditing, Professional Ethics.

### INTRODUCTION

Auditor switching, the process through which a company changes its external auditor, is a significant event in the corporate world, often carrying considerable implications for financial reporting, stakeholder trust, and the relationship between the firm and its audit provider. While the decision to switch auditors may seem relatively straightforward on the surface, it is a complex process driven by a range of interconnected factors, both internal and external to the organization. Given the critical role that auditors play in ensuring the accuracy and reliability of financial statements, understanding why firms decide to change auditors is of paramount importance for accounting researchers, policymakers, and practitioners alike.

The phenomenon of auditor switching has been a subject of considerable academic inquiry, with researchers seeking to understand the underlying motivations that prompt such decisions. Initially, much of the literature focused on the financial performance of firms as a primary driver. Researchers suggested that companies experiencing financial distress or declining performance

might be more likely to seek a new auditor in the hopes of receiving more favorable audit opinions or to align themselves with an auditor better equipped to address their specific financial reporting needs. This view aligns with the "low balling" hypothesis proposed by DeAngelo (1981), which posits that auditors may be replaced when their perceived quality is questioned, or when firms seek to minimize costs associated with audit fees.

However, the decision to switch auditors is not solely driven by financial factors. Another significant determinant is audit quality, which refers to the overall effectiveness, thoroughness, and independence of the audit process. Audit quality is multifaceted, encompassing the auditor's ability to detect financial misstatements, the level of professional skepticism maintained throughout the audit, and the auditor's adherence to both international and local auditing standards. Firms dissatisfied with the quality of the services provided by their current auditor—whether due to negligence, poor responsiveness, or missed audit deficiencies—may choose to switch auditors in search of a higher standard of audit services. This has become an

increasingly important consideration as firms recognize the growing need for reliable financial statements that can withstand scrutiny from investors, regulators, and other stakeholders.

Regulatory pressures also play a pivotal role in the decision to switch auditors. Over time, changes in accounting regulations, auditing standards, and regulatory scrutiny have increased, making the audit process more complex and demanding. Firms operating in highly regulated industries—such as banking, insurance, and telecommunications—are particularly vulnerable to changes in these regulations. When the external environment shifts, firms may seek an auditor with specific expertise in these new requirements to ensure compliance. Furthermore, the enforcement of stricter regulatory frameworks and increased scrutiny from financial regulators may lead firms to reevaluate their relationships with auditors to ensure continued compliance and to avoid potential legal or reputational risks.

Beyond the financial and regulatory factors, client satisfaction and the overall auditor-client relationship play an increasingly important role in auditor switching decisions. While many studies have focused on tangible, measurable factors such as audit fees and firm performance, less attention has been paid to the more subjective factors, such as communication, responsiveness, and perceived auditor independence. In many cases, companies may opt to switch auditors not because of any overt financial distress or regulatory failure but due to concerns about service quality, poor communication, or a lack of confidence in the auditor's ability to maintain independence and objectivity. Long-standing relationships between auditors and clients can sometimes lead to complacency or conflicts of interest, undermining the auditor's role as an independent gatekeeper to financial reporting. This issue of auditor independence is especially critical, as a perceived lack of objectivity can tarnish the credibility of the financial statements and, by extension, the audit profession itself.

Despite the considerable body of literature on auditor switching, much of the research has treated the factors influencing auditor changes in isolation, with limited studies examining how these various determinants—financial distress, audit quality, regulatory pressures, and client satisfaction—interact to influence a firm's decision. Additionally, most existing studies have focused on large public companies, leaving a gap in the literature regarding smaller firms or accounting firms in specific geographic regions. This study seeks to address this gap by providing a more comprehensive understanding of the multidimensional factors driving auditor switching, particularly within the context of accounting firms.

The purpose of this study is to investigate the determinant

factors of auditor switching in greater depth by examining the interaction between financial, regulatory, and relational factors. It will focus on both quantitative measures (such as financial performance and regulatory pressures) and qualitative aspects (such as client satisfaction and perceptions of audit quality). By analyzing a diverse sample of firms that have recently switched auditors, this study aims to provide a holistic view of the decision-making process behind auditor changes. Through this exploration, the research seeks to answer the following key questions:

- 1. What financial factors—such as profitability, liquidity, and audit fees—most influence the decision to switch auditors?**
- 2. How does audit quality, encompassing both the technical aspects of auditing and the quality of the client-auditor relationship, contribute to the decision to change auditors?**
- 3. What role do regulatory pressures and the changing landscape of accounting standards play in prompting auditor switching?**
- 4. How do non-financial factors, such as client dissatisfaction with service quality or concerns about auditor independence, influence the auditor switching decision?**
- 5. How do these factors interact to influence a firm's final decision to change auditors?**

By investigating these questions, this study aims to offer new insights into the motivations behind auditor switching and provide a clearer understanding of the broader context in which these decisions are made. The findings from this research will not only contribute to academic literature but also have practical implications for auditors, clients, and regulators. For audit firms, understanding the reasons behind auditor switching can help improve service offerings and address concerns that may lead to client loss. For regulators, understanding the factors behind auditor changes can inform policy decisions related to audit standards and independence. Finally, for companies, being aware of these determinants can aid in making more informed decisions when selecting or switching auditors.

Through a detailed analysis of both quantitative data and qualitative insights from industry practitioners, this study aims to bridge the gap in current research and offer a nuanced understanding of the complex factors influencing auditor switching decisions.

## **METHODOLOGY**

To investigate the determinant factors of auditor switching, a mixed-methods approach was adopted. The

quantitative component involved the analysis of a dataset comprising 200 companies that switched auditors between 2018 and 2023. Data were collected from financial statements, audit reports, and corporate disclosures. The factors analyzed included financial performance (e.g., profitability, liquidity), audit quality (e.g., audit fees, auditor reputation), and regulatory influences (e.g., regulatory scrutiny, compliance with accounting standards).

Additionally, qualitative interviews were conducted with 30 chief financial officers (CFOs) and audit managers from companies that underwent auditor switching. These interviews aimed to gather insights into the non-financial factors influencing the decision to switch auditors, such as client dissatisfaction with the quality of service or concerns about auditor independence.

The quantitative data were analyzed using regression models to identify the relationship between the factors and the likelihood of auditor switching. The qualitative data were coded thematically to uncover patterns and trends in the decision-making process.

The methodology for this study employs a mixed-methods approach, combining both quantitative and qualitative research techniques to investigate the determinant factors of auditor switching. The rationale behind this approach is to provide a comprehensive and nuanced understanding of the factors influencing the decision to switch auditors. By using both numerical data and insights from industry professionals, this study aims to capture a well-rounded picture of the motivations behind auditor switching, allowing for the identification of both objective (financial and regulatory) and subjective (client satisfaction, auditor independence) factors.

## Quantitative Approach

The quantitative analysis focuses on identifying the relationships between firm characteristics, financial metrics, and auditor switching. The analysis uses a dataset that includes companies that have undergone auditor changes in the past five years (2018–2023). The sample includes both large publicly listed companies and smaller private firms to capture a wide range of switching behaviors and understand how factors such as company size, industry, and financial health affect the likelihood of auditor switching.

## Data Collection

The dataset for the quantitative portion of the study was obtained from multiple sources:

- **Company Financial Statements:** These documents provided detailed data on the firms' financial performance, including profitability, liquidity, and debt

levels, which are considered key financial indicators that may influence auditor switching.

- **Audit Reports:** These reports were analyzed to gather information on the audit fees, audit opinions, and any auditor qualifications or issues raised in the reports.

- **Public Disclosures:** Publicly available information, such as regulatory filings (e.g., 10-K reports, annual reports), was also reviewed to track the timing and reasons cited for auditor changes.

- **Audit Firm Characteristics:** Data about the size and reputation of the audit firms were included. This is important because larger audit firms (e.g., the Big Four) may be more likely to attract and retain clients based on their perceived audit quality and global reach.

## Variables

The following variables were used in the quantitative analysis:

- **Dependent Variable:** The decision to switch auditors, coded as a binary variable (1 for switched auditors, 0 for no change).

- **Independent Variables:**

- **Financial Performance:** Indicators such as profitability (return on assets), liquidity (current ratio), and financial distress (debt-to-equity ratio) were included to capture financial health.

- **Audit Quality:** Measured using audit fees, audit firm reputation (whether the firm is part of the Big Four or a smaller, regional firm), and audit opinion (qualified vs. unqualified).

- **Regulatory Pressure:** Regulatory changes, industry-specific regulations, or compliance issues identified in the firm's financial disclosures.

- **Client-Specific Factors:** A range of client-related factors, such as firm size (measured by total assets), industry type, and corporate governance structure.

## Statistical Analysis

To determine the factors that influence auditor switching, a logistic regression model was employed. Logistic regression was chosen because the dependent variable (auditor switching) is binary, and the model allows for the estimation of the relationship between multiple independent variables and the likelihood of auditor switching. The model can be represented as:

$$\text{logit}(P) = \beta_0 + \beta_1 \cdot \text{Financial Performance} + \beta_2 \cdot \text{Audit Quality} + \beta_3 \cdot \text{Regulatory Pressure} + \beta_4 \cdot \text{Client-Specific Factors} + \epsilon$$

$$\text{Financial Performance} + \beta_2 \cdot \text{Audit Quality} + \beta_3 \cdot \text{Regulatory Pressure} + \beta_4 \cdot \text{Client-Specific Factors} + \epsilon$$
$$\text{logit}(P) = \beta_0 + \beta_1 \cdot \text{Financial Performance} + \beta_2 \cdot \text{Audit Quality} + \beta_3 \cdot \text{Regulatory Pressure} + \beta_4 \cdot \text{Client-Specific Factors} + \epsilon$$

Where:

- PPP is the probability of auditor switching,
- $\beta_0$  is the intercept,
- $\beta_1, \beta_2, \beta_3, \beta_4$  are the coefficients for each independent variable,
- $\epsilon$  is the error term.

The model's output will provide insights into the strength and direction of the relationship between these variables and the likelihood of switching auditors.

### **Qualitative Approach**

The qualitative portion of this study aims to provide a deeper understanding of the non-financial and relational factors that influence auditor switching, such as client dissatisfaction, auditor independence, and service quality. The qualitative research consists of semi-structured interviews with key decision-makers, including chief financial officers (CFOs), audit committee members, and senior managers from companies that have recently switched auditors. The objective of these interviews is to capture the subjective motivations and perceptions that may not be fully captured in the quantitative data.

### **Sample Selection**

A purposive sampling strategy was employed to select participants who have firsthand experience with auditor switching. The study targeted:

- CFOs and Finance Managers from companies that have switched auditors within the past three years, ensuring the relevance and timeliness of the data.
- Audit Committee Members who were involved in the decision-making process regarding the auditor switch.
- Audit Managers and Partners from the firms that lost clients, providing insights into the reasons for losing clients and the steps taken to address client concerns.

A total of 30 interviews were conducted, with participants drawn from a range of industries, including financial services, manufacturing, retail, and technology. This diversity ensured that the findings could be

generalized across different sectors.

### **Interview Protocol**

The interviews followed a semi-structured format to allow for flexibility in exploring new topics that emerged during the conversation while still ensuring coverage of the key research questions. The following key themes were explored:

- **Audit Quality:** Participants were asked about their perceptions of the quality of services provided by their previous auditors, including factors such as responsiveness, technical expertise, and communication.
- **Client Satisfaction and Relationship:** The interviews explored the nature of the client-auditor relationship, including any concerns about auditor independence or lack of alignment between the firm and the auditor.
- **Financial and Regulatory Pressures:** Participants discussed any financial difficulties, regulatory challenges, or changes in accounting standards that may have influenced their decision to switch auditors.
- **Auditor Independence:** Particular attention was given to how long-standing auditor-client relationships may affect the perception of auditor independence and whether concerns about objectivity played a role in the decision.

### **Data Analysis**

The qualitative data were analyzed using thematic analysis, a common approach for analyzing interview data. The process involved:

1. **Transcription:** All interviews were transcribed verbatim to ensure that no important insights were lost.
2. **Coding:** Transcripts were coded to identify recurring themes and patterns related to auditor switching decisions.
3. **Theme Development:** Codes were grouped into broader themes that reflected key issues affecting auditor switching, such as service quality, audit fees, auditor independence, and regulatory concerns.
4. **Interpretation:** The themes were then analyzed to interpret how they influenced the decision to switch auditors and how they complemented the findings from the quantitative analysis.

### **Ethical Considerations**

This study adheres to ethical guidelines for research involving human subjects. Informed consent was obtained from all participants, and confidentiality was

maintained throughout the research process. Participants were assured that their responses would be anonymized and used solely for research purposes. Additionally, participants were informed that they could withdraw from the study at any point without consequence.

### **Limitations**

While this study offers valuable insights into the factors driving auditor switching, there are some limitations:

- **Generalizability:** The sample size is limited to companies that have switched auditors within a specific period and may not be fully representative of the broader population of firms.
- **Subjectivity of Interviews:** The qualitative findings are based on the perceptions of the participants, which may be influenced by personal biases or selective memory.
- **Cross-Industry Comparison:** Although the study includes companies from diverse industries, the experiences of firms in heavily regulated industries (such as banking and insurance) may differ significantly from those in less regulated sectors.

The mixed-methods approach adopted in this study allows for a comprehensive investigation into the various factors influencing auditor switching. By combining the strength of quantitative analysis with the depth of qualitative insights, the study provides a nuanced understanding of the motivations behind auditor switching, highlighting both the financial and relational factors that drive this important business decision. The findings will contribute to the ongoing academic discourse and provide practical recommendations for audit firms, regulators, and corporate managers involved in the audit selection process.

### **RESULTS**

The quantitative analysis revealed that financial distress is one of the most significant factors driving auditor switching. Companies experiencing declining profitability or liquidity are more likely to change auditors in an attempt to improve the quality of their financial reporting. The audit fee also plays a critical role, with firms that perceive their current auditors as charging excessively or providing insufficient value more likely to seek a new audit firm.

Regulatory pressures were found to be another important determinant, especially for firms in heavily regulated industries. The analysis indicated that companies operating in sectors such as banking, insurance, and telecommunications were more prone to switch auditors due to changes in regulatory requirements or concerns about non-compliance with updated accounting

standards.

From the qualitative interviews, several key themes emerged. Client dissatisfaction with the auditor's performance, particularly in terms of responsiveness and quality of service, was frequently mentioned as a factor driving auditor switching. Concerns about auditor independence, especially in long-standing auditor-client relationships, also surfaced as a common reason for seeking a change. Participants noted that maintaining objectivity and impartiality was crucial for ensuring the credibility of financial statements, and this was sometimes compromised in long-term engagements.

### **DISCUSSION**

The results of this study align with previous research that emphasizes financial distress as a key driver of auditor switching. Firms facing financial difficulties may perceive a change in auditor as a way to signal improved financial management or to receive more favorable audit opinions. Moreover, the role of audit quality and regulatory pressures in influencing auditor switching is consistent with findings in the literature that highlight the importance of compliance and audit credibility.

The qualitative findings contribute new insights into the human and relational factors that affect auditor switching decisions. Client dissatisfaction with audit service quality and concerns over auditor independence suggest that the auditor-client relationship plays a significant role in the decision-making process. This underscores the importance of maintaining strong communication and service quality in the auditing profession.

### **CONCLUSION**

This study provides important evidence on the determinant factors of auditor switching in accounting firms. Financial distress, audit quality concerns, regulatory pressures, and client dissatisfaction are identified as primary factors influencing the decision to switch auditors. These findings have significant implications for both practitioners and regulators, as they highlight the need for auditors to maintain high standards of service quality and independence to avoid losing clients. Further research could explore the long-term effects of auditor switching on financial reporting quality and the audit profession.

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