The current issue and full text archive of this journal is available at
www.jraba.org
Jurnal Riset Akuntansi dan Bisnis Airlangga Vol. 4. No. 2 (2019) 707- 727 ISSN 2548-1401 (Print) ISSN 2548-4346 (Online)

MARKET REACTION ON SWITCHING TO INDUSTRY EXPERT AUDITOR: EVIDENCE FROM THE UK

Nur Aulia Rahmah[1]

ABSTRACT

Penelitian ini bertujuan untuk menguji apakah terdapat sebuah hubungan positif antara cumulative abnormal returns (CAR) dan keputusan perusahaan untuk menggunakan auditor spesialis industri. Dari 2.097 populasi perusahaan yang terdaftar di London Stock Exchange selama tahun 2003-2013, terdapat 118 sampel perusahaan non-keuangan yang mengganti auditornya dan memiliki data lengkap. Metodologi studi peristiwa digunakan atas data sekunder dari laporan keuangan, database Nexis dan Thomson Reuters Spreadsheet Link. Hasil penelitian menunjukkan bahwa tidak terdapat respon pasar modal yang signifikan ketika perusahaan mengganti auditornya dari non-spesialis industri ke spesialis industri. Akan tetapi, uji t atas CAR menunjukkan bahwa secara umum pasar modal bereaksi secara signifikan terhadap pengumuman pergantian auditor. Hasil ini bermanfaat bagi manajemen dengan mengindikasikan bahwa investor peduli dengan pergantian auditor itu sendiri namun tidak mempertimbangkan spesialisasi industri auditor yang baru. Sehingga manajemen perusahaan harus memberikan perhatian kepada aspek lain yang lebih firm-specific.

Keyword : ***Cummulative abnormal returns*, reaksi pasar modal, pergantian auditor, auditor spesialis industri**

ARTICLE INFO

***Article History*:**

Received 19 August 2019

Accepted 12 October 2019

Availabe online 30 November 2019

Introduction

This study investigates the stock market reaction after a firm listed in London Stock Exchange decided to switch its auditor to the one who is more expert in its industry. In particular, it examines the possibility of positive stock market reactions that are triggered by the expectation that the firm would potentially have a better audit quality if it is audited by the industry expert auditor. If this study reveals that the market reacts positively to the auditor switch to an industry expert auditor, management should realize that the decision of the successor auditor selection has another incentive for the firm besides better auditor's quality. That is in the form of higher abnormal returns. Although public disclosure of auditor changes is importantly required. Klock (1994) reports no significant association between stocks' price and switching in certifying accountants. From this finding, it can be concluded that the market participants ignore auditor switches, do not perceive any valuable new information there. This study agrees with prior literature

[1] Corresponden Author : Dosen Akuntansi Fakultas Ekonomi dan Bisnis Universitas Indonesia
Telp. 08111117636
Email : rahmah.naulia@gmail.com

Jurnal Riset Akuntansi dan Bisnis Airlangga Vol. 4. No. 2 (2019) 707-727
ISSN 2548-1401 (Print) ISSN 2548-4346 (Online)

from Nichols and Smith (1983), observing that there is not any statistically significant magnitude of the difference in the reactions to a change in auditors. Both studies may be overly old-fashioned in today's context so that the outcome could be irrelevant. Still, those shall be referenced as steppingstones for the body of literature regarding auditor switch.

Opinion shopping as the opportunistic behavior by management is the principal interest in auditor switch. It may be presumably argued that managers in poorly performing firms evade qualified opinion as it could reduce the market price of the firm's security and their compensation. Hence, they tend to switch auditors wishing a cleaner opinion issuance (Chow and Rice, 1982). If the investing public apprehends this as the underlying reason of auditor switch, then there will be a significant adverse reaction in the stock market. Furthermore, other notions said that auditor switch is costly in starting up and raises the risk of audit failure. The latter is caused by more reliance on the firms' management estimates in the initial periods of engagement. Consequently, this promotes auditors to acquire firm-specific experience and expertise over time, assisting them to comprehend the firms' particular business. Myers *et al*.,(2003) prove that the longer the relationship between the auditor and its client, the less that the client's management imposes extreme income-increasing and decreasing accruals. This prompts that longer auditor tenure limits management to exploit accruals to raise current period earnings and/or build a reserve to carry out future earning.

Apart from those possibilities of perception owned by the investing public, markets do not blindfold themselves from the Enron scandal in the United States (US). The scandal provides evidence of auditor independence impairment that is parallel with the length of auditor and client relationship. The too close and too long relationship between auditor and client inflict involvement of the auditor in the resolutions that management makes regarding the presentation of financial statements. These might induce the financial statements to comprise disreputable quality earnings deluding investors in allocating their funds, like what Enron and Arthur Andersen did. Therefore, later researches present a positive association between the stock market's reaction and auditor switch (Knechel *et al*., 2007; Chang *et al*., 2010; Krishnan *et al*., 2013).

On another side, a significant body of literature has developed exploring industry specialist auditors. Industry specialization originates from "the firm's human capital investment in accounting professionals" (Francis *et al*., 2005). Most researches specify industry specialization based on the portion of the industry audited. Particular accounting firm shall be denominated as industry specialist auditor if it is one of the Big4 (Knechel *et al*., 2007) and serves more than 15% of industry sales (previously 10% cut off before the consolidation of the Big8 into the Big6 (Dunn *et al*., 2004).

Simunic and Stein (1987) view that the audit services market is characterized by differentiation. As the demand for audit services is obtained following the objective of each purchaser of the service, audit firms seek to compete in the market by differentiating their products and use industry specialization as their strategy. How they compete is by investing in technologies, physical facilities, personnel,and organization control system that is convinced could sharpen the audit