



Published every April, August and December

JURNAL RISET AKUNTANSI & KEUANGAN

ISSN:2541-061X (Online). ISSN:2338-1507(Print). <http://ejournal.upi.edu/index.php/JRAK>



Analysis of Public Accounting Firm Services and Audit Quality with Structure Conduct Performance Approach in Indonesia Capital Market

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Abstract. *The business aspect of the audit services may lead to abnormal fee audits. This happens because the supply and demand in audit services are unbalanced resulting in an oligopolistic market, in which the audit engagement is concentrated in several public accounting firms. Such market concentration will lead to the structure conduct performance paradigm because the market structure of an industry will cause behavioral changes especially in the determination of reasonable audit fees and will ultimately affect the quality of audit services itself. This study aims to 1) test and analyze the direct effect of audit service market concentration on audit quality in Indonesia capital market; 2) test and analyze the indirect effect of audit service market concentration on audit quality through positive abnormal audit fee in Indonesian capital market. The research was conducted using a quantitative descriptive method. Research data is in the form of secondary data from capital market in Indonesia. The results show that market concentration has not an effect on the decreased audit quality, but market concentration has an effect on increase abnormal fee.*

Keywords: *market structure; audit fee; audit quality*

Abstrak. *Aspek bisnis dari layanan audit dapat menyebabkan audit biaya tidak normal. Hal ini terjadi karena pasokan dan permintaan dalam layanan audit tidak seimbang yang mengakibatkan pasar oligopolistik, di mana keterlibatan audit terkonsentrasi di beberapa kantor akuntan publik. Konsentrasi pasar seperti itu akan mengarah pada struktur melakukan paradigma kinerja karena struktur pasar suatu industri akan menyebabkan perubahan perilaku terutama dalam penentuan biaya audit yang wajar dan pada akhirnya akan mempengaruhi kualitas layanan audit itu sendiri. Penelitian ini bertujuan untuk 1) menguji dan menganalisis pengaruh langsung konsentrasi pasar layanan audit terhadap kualitas audit di pasar modal Indonesia; 2) menguji dan menganalisis pengaruh tidak langsung konsentrasi pasar layanan audit terhadap kualitas audit melalui biaya audit abnormal yang positif di pasar modal Indonesia. Penelitian ini dilakukan dengan menggunakan metode deskriptif kuantitatif. Data penelitian berupa data sekunder dari pasar modal di Indonesia. Hasil penelitian menunjukkan bahwa konsentrasi pasar tidak berpengaruh pada penurunan kualitas audit, tetapi konsentrasi pasar berpengaruh pada peningkatan biaya abnormal.*

Kata Kunci: *struktur pasar; biaya audit; kualitas audit*

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How to cite this article. Sofia, A, Apandi Nelly, R (2018). *Analysis of Public Accounting Firm Services and Audit Quality with Structure Conduct Performance Approach in Indonesia Capital Market. Jurnal Riset Akuntansi Dan Keuangan. Program Studi Akuntansi. Fakultas Pendidikan Ekonomi dan Bisnis Universitas Pendidikan Indonesia, 6(1), 147-154.* Retrieved from <http://ejournal.upi.edu/index.php/JRAK/article/view/13697>

History of article. Received: January 2018, Revision: Maret 2018, Published: April 2018

Online ISSN: 2541-061X. Print ISSN: 2338-1507. DOI : 10.17509/jrak.v6i1.13697

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INTRODUCTION

As an effort to reduce the occurrence of agency conflict, the need for quality audit services become more important. In order to achieve high audit quality, good planning is required including proper audit cost determination. Auditors are required to always be professional in carrying out their duties, but it cannot be denied that the business aspect of the audit services is now also an important consideration for auditors to make an engagement with auditee. Dominant business-side considerations and ignoring professionalism may lead to abnormal audit fee and ultimately result in low audit quality.

Abnormal audit fee may occur under various conditions. Firstly, audit fees received by auditors are lower than reasonable service fee to achieve a good audit quality Fitriany et al (2016). This happens because of the excessive discount of audit fees and raises doubts about the auditor's ability to apply applicable professional standards. Secondly, audit fees received by auditors are higher than reasonable service fee by providing a guarantee of opinion in accordance with auditee expectations Fitriany et al (2016). This makes the auditor receive premium audit fee at the expense of its independence. The economic dependence of the auditor on the client so that the audit engagement in the following year is not replaced by another auditor causes the auditor to be willing to provide the opinion expected by the auditee.

Previous researches on audit fees and audit quality still show different results. Researches conducted by Hoitash et al (2007) and Ettredge et al (2014) stated that an abnormal audit fee or fee pressure may degrade audit quality. Kraub et al (2015) and Fitriany et al (2016) explained that positive abnormal fee negatively affects audit quality. Further, a research conducted by Lim et al (2013) explained that increased non-audit service fees and audit service fees (total fees) will degrade audit quality only in companies with low institutional ownership, while firms with high institutional ownership indicate that high total fees can improve audit quality. By using primary data in Indonesia, Rahmina &

Agoes (2014) proved that high audit cost can improve audit quality because high audit fee is assessed to encourage auditors to make more effort in order to improve audit quality.

The study of audit fees based on the results of meta regression analysis conducted by Hay et al (2006) concluded that the researchers always associate audit fee with 2 (two) variables: auditor independence and audit market share. A study that correlates audit fees with independence will be related to a review of audit quality and research linking audit fees with audit market share will be related to supply-demand assessment of audit services. High demand audit services that are not followed by a balanced supply of auditing services allow for an abnormal audit fee. The limited supply may result in the emergence of a fake public accounting firm offering audit services in the absence of the required audit standards, resulting in low audit fees of reasonable fees in order to produce good audit quality. The limited supply may also lead to a monopoly on the audit services market and may result in higher audit fee than the fair amount of audit fees.

The presence of the top-ranking public accounting firm causes the audit services market to be concentrated in several large public accounting firms. Engagement with the BIG4 public accounting firm is judged by some to be better than engagement with the non-BIG4 public accounting firm. A research conducted by Lee & Park (2013) stated that BIG4 CPA have a better quality than Non-BIG4 CPAs. Therefore, companies with high corporate ethics, according to Houque et al (2015), would prefer to make an audit engagement with BIG4 CPA. Stock market issuers also believe that audit engagements with high reputation firms is considered to be responded positively by investors despite low levels of corporate governance. Fan & Wong's research (2005) proved that the decision to use BIG4 auditor services will be even higher in companies with high agency conflicts and concentrated ownership structures and companies requiring additional funds to manage their businesses. Shareholders will be confident that the use of BIG4 CPA can

reduce the presence of asymmetric information due to concentrated shareholdings. Furthermore, the decision to use the service of BIG4 CPA is also considered to be an attraction for investors to make investment decisions.

The increasing use of BIG4 CPA audit services raises concerns about the concentration of audit service market share only in certain CPAs. In the perspective of economics, there is a paradigm called Structure-Conduct-Performance Paradigm which explains that there is a linkage of the structure of an industry with its behavior and performance. This paradigm was first developed by Bain in 1959 which became the pillar of the industry organization theory. In general, this paradigm illustrates that the structure of an industry is indicated by the presence or absence of concentration from market participants. If there are few market participants in the supply side then the participants will have the power that affect the behavior and will ultimately affect its performance. Changes in market behavior that are concentrated in audit services are the appearance of abnormal audit fees set by the auditor. High market concentration will lead to reduced competitive climate to improve the quality of audit. A study conducted by Campa (2013) proved the existence of a premium audit fee imposed by the BIG4 public accounting firms and the determination of such fees is unrelated to efforts to improve audit quality. Based on the above description, it is important to conduct a research with the aim to review 1) the direct effect of market concentration of audit service to audit quality; 2) the direct effect of market concentration of audit services to audit quality through abnormal audit fee.

This research is a replication of a research conducted by Eshleman (2013). The difference from the current study is in the use of Indonesia sample. Research on audit services market in Indonesia is interesting to be studied because the capital market in Indonesia tends to develop and is currently in a growth phase compared to other large-scale capital markets. This research is presented

into 5 sections: 1) research background, 2) literature review, 3) research method, 4) discussion and 5) conclusion and suggestion.

LITERATURE REVIEW

The Effect of Market Concentration of Audit Services on Audit Quality

The market concentration of audit services at several public accounting firms creates an oligopoly market. Such market form has the disadvantage of being able to reduce the climate of competition among public accounting firms (Afriansyah & Siregar, 2007; Eshleman, 2013; Viska et al., 2013; Hung et al., 2016). The limited supply compared to the demand of the audit services causes the auditor not to make maximum efforts in performing audit procedures to obtain high audit quality because the auditor feels that the auditee does not have a large selection of public accounting firms to obtain audit services. A research conducted by Viska et al (2013) demonstrated that a concentrated audit market can degrade audit quality, as evidenced by the increasingly restatement of financial statements (Eshleman, 2013).

The negative impact of the audit market that is concentrated on big four public accounting firms may reduce the quality of the audit. This has been responded differently by some other researchers because the engagement with the big four accounting firms was considered capable of providing better audit quality because of several reasons. Firstly, public accounting firms with larger sizes in this case are big four CPAs often face higher lawsuits than CPA with smaller size (non-big four). Auditors with a high reputation are often called "deeper pockets". Therefore, when big four auditors make mistakes in the audit process, the public will highlight more sharply than the non-big four auditors, so they are more often the target of compensation claims due to unqualified audit reports (Becker et al, 1998; Chung & Firth, 2003; Francis, 2004; Lee & Park, 2013).

Secondly, the Big Four public accounting firms have focused more attention on efforts to reduce asymmetric information between agents and principals compared with

Non-Big Four CPAs, this is because Big Four public accounting firms have the ability to assess the adequacy of disclosures in financial statements better than Non- Big Four, so their audit quality are better (Francis et al, 1999; Lee & Park, 2013).

Thirdly, big four public accounting firms have better quality management systems and PCAOB inspections take place more often than non-big four CPAs, because in general big four CPAs have more clients (Lee & Park, 2013). In the United States, PCAOB conducts annual inspections of the Big Four public accounting firms, while the Non-Big Four public accounting firms are inspected every three years. Fourthly, Big Four public accounting firms have better accounting and auditing capabilities than Non-Big Four because they have better audit technology and have the ability to better retain their findings (DeFond & Jiambalvo, 1993; Lowensohn et.al, 2007; Francis & Wang, 2008; Lee & Park, 2013). Auditors at Big Four CPAs have more specific expertise in certain areas such as CISA Information System Auditor, CFE forensic auditor and other expertise specifications.

Based on the above description, it can be concluded that high market concentration of audit services can cause a decreasing competition climate that will lead to low quality audit. However, high concentration is considered capable of improving audit quality due to better audit resources and monitoring system.

H₁ = Market Concentration of Audit Services Has Negative Influence on Audit Quality

Effect of Market Concentration of Audit Services on Audit Quality through Positive Abnormal Audit Fee

The structure of the audit services industry is indicated by the presence or absence of concentration from the public accounting firm. If the audit services market is concentrated in only a few public accounting firms, then the public accounting firm will have a great power so as to change auditor behavior and ultimately can affect the quality of the audit, as reflected in a paradigm

known as structure-conduct-performance (Bain, 1969). The concentrated market has 2 (two) adverse impacts that will lead to collusion either explicitly or implicitly and the presence of other side obstacles to enter into the company, thus causing the price or profit to be higher (Weiss, 1979).

Changes in market behavior that are concentrated in audit services are the appearance of abnormal audit fees set by the auditor. Abnormal audit fee can occur in the two conditions. Firstly, audit fees that are lower than the reasonable audit fee (negative abnormal audit fee). Secondly, audit fees that are higher than the reasonable audit fee (Choi et al, 2010; Blankley et al, 2012, Fitriany et al 2016). In a high concentrated market, the possibility of a positive abnormal audit fee is higher than the negative abnormal audit fee, because the auditor has a better bargaining power position so that it will set a higher audit fee. A study conducted by Campa (2013) proved a premium audit fee imposed by the Big 4 public accounting firms. Further research conducted by Huang et al (2016) stated that concentrated audit market leads to increased audit costs.

Based on the above description, it can be concluded that the high concentration of audit services market can generate great power for the public accountant firms to determine the high audit fee so that Positive Abnormal Fee will occur in market with high concentration.

H₂ = Market Concentration on Audit Services Has Positive Effect on Abnormal Audit Fee

H₃ = Abnormal Audit Fee Has Negative Effect on Audit Quality

METHODOLOGY

This study uses cross-country data in Indonesia capital market. Observation period in this research is from 2016. Research data obtained are 1200 samples. This study uses a development model of research conducted by Eshleman (2013) and Huang et al (2016) which formulated by the following regression equations and research paradigms

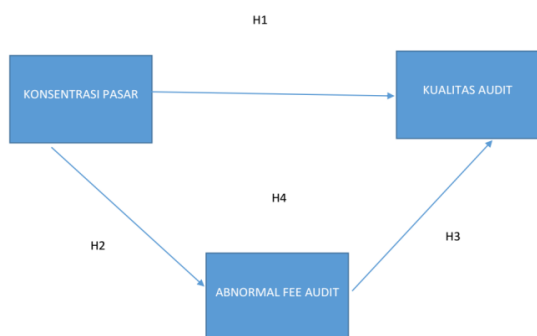


Figure 1. Research Model

RESULT AND DISCUSSION

After the classical assumption test, regression analysis is conducted to find out the interrelationship between variables. The following is the result of regression of data on Indonesia capital market. The first is to test directly to determine the effect of market concentration on audit quality.

Table 1 Results of Regression of Equations (1)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
CONS	-37802845	1.84E+08	-0.205049	0.8378
LN_ASSET	-5520161.	5510873.	-1.001685	0.3182
CURRENT	-143086.7	1379602.	-0.103716	0.9175
PROFIT_LOSS	18732795	21320866	0.878613	0.3811
LN_RECEIVABLE	6381862.	6291591.	1.014348	0.3121
BIG_FOUR	-14518556	21922581	-0.662265	0.5089
R-squared	0.016953	Mean dependent var	5838162.	
Adjusted R-squared	-0.017181	S.D. dependent var	1.20E+08	
S.E. of regression	1.21E+08	Akaike info criterion	40.09277	
Sum squared resid	2.09E+18	Schwarz criterion	40.21319	
Log likelihood	-3000.957	Hannan-Quinn criter.	40.14169	
Durbin-Watson stat	2.166057			

Based on the result of regression in table 1, it can be concluded that market concentration has not an effect on audit quality with 5% significance level. This study not supports the results of previous research conducted Eshleman (2013).The second regression result is done to find out the

indirect effect between market concentration of audit service and audit quality through abnormal audit fee. Below is the regression result to see the effect of market concentration on abnormal fee:

Table 2 Results of Regression of Equations (2)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
CONS	16163320	2167150.	7.458331	0.0000
CURRENT	4192.373	16217.22	0.258514	0.7964
LN_ASSET	-57740.24	64780.28	-0.891324	0.3742
PROFIT_LOSS	72226.05	250626.7	0.288182	0.7736
LN_RECEIVABLE	63429.94	73957.62	0.857652	0.3925
BIG_FOUR	-1082104.	257699.8	-4.199088	0.0000
R-squared	0.289521	Mean dependent var	-117072.1	
Adjusted R-squared	0.264852	S.D. dependent var	1653194.	

S.E. of regression	1417462.	Akaike info criterion	31.20581
Sum squared resid	2.89E+14	Schwarz criterion	31.32624
Log likelihood	-2334.436	Hannan-Quinn criter.	31.25474
Durbin-Watson stat	1.396834		

Based on the result of regression in table 2, it can be concluded that high concentrated market the possibility of positive abnormal audit fee. A study conducted by Campa (2013) proved a premium audit fee imposed by the BIG 4 public accounting firm. Further research conducted by Huang et al

(2016) stated that concentrated audit markets lead to increased audit costs. The results of this study are entirely in line with the results of research conducted by Choi et al (2010), Blankley et al (2012), Fitriany et al (2016).

Table 3 Results of Regression of Equations (3)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
PABNFEE	9.161132	5.973286	1.533684	0.1273
LN_ASSET	-5201125.	5468391.	-0.951125	0.3431
CURRENT	-110862.5	1366955.	-0.081102	0.9355
PROFIT_LOSS	15493984	21073832	0.735224	0.4634
LN_RECEIVABLE	6070459.	6240665.	0.972726	0.3323
BIG_FOUR	-13060575	20201141	-0.646527	0.5190
R-squared	0.032470	Mean dependent var	5838162.	
Adjusted R-squared	-0.001125	S.D. dependent var	1.20E+08	
S.E. of regression	1.20E+08	Akaike info criterion	40.07686	
Sum squared resid	2.06E+18	Schwarz criterion	40.19728	
Log likelihood	-2999.764	Hannan-Quinn criter.	40.12578	
Durbin-Watson stat	2.155889			

Based on the result of regression in table 3, it can be concluded that abnormal fee has not an effect on audit quality with 5% significance level. The results of this study indicate that abnormal audit fee can not encourage auditors to shorten the important audit procedures that may cause auditors will give wrong opinions and misleading readers of financial statements. This study provides results that are not in line with research conducted by Hoitash et al (2007) and Ettredge et al (2014) stating that abnormal audit fee or fee pressure may degrade audit quality.

Based on the result of regression equation 1,2 and 3, it is found that indirect effect of market concentration of audit service Below is a model chart between variables.

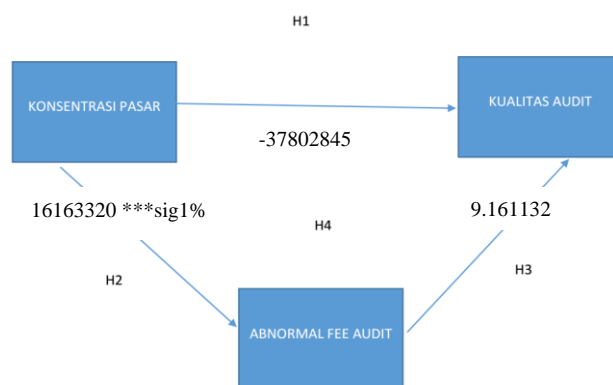


Figure 2. Regression Result of Indonesian Data

CONCLUSION

The results of the research in Indonesia capital market shows that abnormal fees have not a negative effect on audit quality. The Structure Conduct Performance paradigm illustrates that market structure will affect the behavior of market participants and will ultimately affect the performance. Audit service market concentrated in some public accounting firms, thus causing the supply of the audit limited in number and is not balanced with the increasing demand. But the concentration market not direct influence to decreasing audit quality because the large CPA firm have a good procedur audit. The results of this study proves that market concentration affects abnormal fees but abnormal fees have not an effect on the decreased of audit quality.

SUGGESTION

Research indicators using secondary data are considered not able to describe the whole of the existing study. Further researchers who are interested in developing this research are suggested to use the composite index, not to use one size only or may use a qualitative research approach that can describe the phenomenon in the field more clearly.

The result of the research shows that the transparency of the financial statements in Indonesia capital market in terms of audit cost information is not optimal, therefore it requires the encouragement of the professional organization of public accountant to improve the transparency of financial statements.

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