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OVERVIEWS OF CONTRACTING THEORY & AGENCY THEORY: DETERMINANTS PUBLIC ACCOUNTING FIRMS SWITCHING ON VOLUNTARY

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Abstract

This study is a literature study to explore research related to factors affecting the voluntary the Public Accounting Firm (PAF) switching, in terms of contract theory associated with the agency theory stated by Watts & Zimmerman (1986). PAF switching may occur due to a regulation or regulation requiring a company to make a the PAF switching called a mandatory replacement, and the PAF switching due to voluntary corporate wishes outside the applicable regulations or voluntary the PAF switching. The result of the study shows that there are 23.9% of companies that make voluntary PAF changes caused by change of management, Financial Distress, PAF Size, Percentage Change of Return On Assets, Client Size and Auditor Opinion. The contract theory may explain research in the field of auditing practice, such as the auditor or PAF related to the auditor's reputation, professionalism, auditor environment, PAF size, and industry specialization. PAF has a brand image which were considered to have a better reputation than with PAF small (Watts & Zimmerman, 1986), it is also supported by De Angelo (1981) states that, large PAFs are preferred by clients because large firms are considered more independent than small PAFs. Agency Theory is often used in research in the field of auditing, because the information asymmetry is the difference of information between the interests of agents and principal interests. Therefore, an independent third party is needed, the auditor, and the role of the auditor only as the monitoring party.

Keywords: Contract Theory, Agency Theory, Public Accounting Firm, Switching

Introduction

Public Accountant is an independent party capable of bridging the interests of shareholders and man-agement, to pro-vide an opinion about the fairness of financial statements. (Salim & Rahayu, 2014). The import-ance of the role of public accountant to make the services of public accountant is needed, resulting in competition between the PAF that affects the com-pany to move from PAF to other PAF (Sulistiarini & Sudarno, 2012). Therefore, to maintain the independence of the auditor against the client, a regulation governing the Public Accounting Service is required, where the client must make The PAF switch-ing within the stipulated time (Jessica, 2014).

The replacement of PAF in Indonesia is regulated in Decree of the Minister of Finance No.423/KMK. 06/2002 and No.359/KMK.06/2003, which is amended in Regulation of the Minister of Finance of the Republic of Indonesia Number 17/PMK.01.2008 on Public Accounting Services. This Regulation states that the provision of general audit services to the financial statements of an entity may be made within 6 consecutive fiscal years by the same PAF and 3 consecutive years by the same auditor to the same client (article 3, paragraph 1). PAF and Public Accountant may receive audit assignments after one year of book does not provide general audit services to the same financial statements (article 3, paragraphs 2 and 3) (Wea & Murdiawati, 2015). The regulation concerning the change of PAF is a regulation that must be obeyed by the client or by the Public Accounting Firm in performing the audit assignment. The PAF switching is the transfer of independent auditor conducted by company (client) in performing audit of financial report. The PAF switching may occur due to a regulation or regulation requiring a company to make a change or rotation of a PAF called a mandatory replace-ment , and The PAF switching due to voluntary corporate wishes outside the applicable regulations or The PAF switching on voluntary. The PAF switching on voluntary is a change of PAF conducted by the company before the stipulated time (Sulistiarini & Sudarno, 2012; Ginting & Fransisca, 2014). The PAF switching on volun-tary, due to several reasons, is generally due to dissatisfaction of audit results. The company may determine the auditor in the assignment of the audit in accordance with the policy specified by the company, to obtain the expected results. Determination of auditors or Public Accounting Firm is expected to get an opinion about the fairness of the presentation of financial statements (Suyono & Yi, 2013).

Research on The PAF switching also occurs in Malaysia, that the PAF switching on voluntary is regulated in Malaysia Institute of Accountant (MIA) as determinant of regulation about auditor rotation or change of partner after 5 (five) years period (Salleh & Jasmani, 2014). While the audit regulation in Singapore, the Accounting and Corporate Regulatory Authority (ACRA) Register Public Accountants, the Public Accounting Firm must comply with the rules set by the Singapore Standards on Auditing (SSA) for the replacement of the auditor within a 5 year period. Accounting Firms that audit companies listed on the Singapore Exchange (SGX) are controlled by ACRA through Singapore Standard Quality Control 1 (SSGC1) (ACRA, 2017). The regulation on the PAF switching on voluntary and auditors switching is expected to maintain the independence of auditors in improving the reliability of financial statements (Sulistiarini & Sudarno, 2012)

The research relating to the practice of auditing is based on the contracting theory proposed by Watts & Zimmerman (1986) that, accounting requires contracts undertaken by the company is a contract between professional auditors with management to conduct auditing activities to reduce corporate agency costs. In auditing research, contract theory has been widely used in auditing practice research. Watts and Zimmerman (1986) also states that the size of the public accounting firm (audit firms size) is considered better and more independent, so that a large PAF has many clients, and has a good brand name. Therefore, the client can determine the PAF option by considering the PAF size, which is basically the selection of this PAF is expected to produce the best opinion. The client's expectation to get the best opinion can be based on hope-related theories. According to Ali Khasharmeh (2015); Luypaert & Van Caneghem (2012) this PAF switching on voluntary can occur due to several factors, including factors of the company (financial difficulties, firm size and others), and factors of the auditor (PAF measure, audit term (tenure), and auditor's opinion.

The difference of opinion about factors causing the PAF switching on voluntary, interesting to be researched because various research in Indonesia and some countries still show different result. Jessica (2014) in his research on 45 manufacturing companies listed on the Indonesia Stock Exchange , there are 15.56% of companies doing PAF switching on voluntary from PAF big four to PAF big four without seeing the time of change whether mandatori or voluntary. Other studies show that there are 23.9% of companies that make PAF switching on voluntary caused by change of management, Financial Distress, PAF Size, Percentage Change of Return On Assets , Client Size and Auditor Opinion (Wea & Murdiawati, 2015).

PAF switching also occurs in some countries in Southeast Asia, such as in Malaysia, 14% influenced by modification opinion and 72,5% influenced by PAF non big big four. The result of the research shows that there is influence of opinion of modification and PAF size to PAF switching voluntary (Salleh & Jasmani, 2014). Another study conducted in a period of 11 years, on 297 companies listed on the Stock Exchange Stock Exchange , stated that there was a change of auditors caused by the financial difficulties of the client and the type of accounting firm (Nasser, 2006). While a study examining 400 firms listed on Bursa Malaysia from 1990 to 2008 states that there is a relationship between company complexity and auditor turnover (Nazrie, et.al, 2012).

One of the factors influencing the PAF switching of Financial Distress, which is a financial condition experienced by the client company, which usually occurs due to the inability to pay the debt as measured by Debt to Equity Ratio. The results of research conducted in 2006-2010 at manufacturing companies listed on the Indonesia Stock Exchange indicate that there is influence of PAF Size and change of management toward auditor turnover, while financial difficulties factor, public ownership and change of audit committee do not affect the change of accountant office (Sulistiarini & Sudarno, 2012 ; Jessica, 2015). The results are different from the research of Suyono, et al (2013) which examines 45 firms listed in Indonesia Stock Exchange in 2012 which states that financial condition, PAF competition level, and tenure have an effect on audit turnover, while firm size has no effect on PAF switching.

Another factor that influences PAF switching on voluntary is firm size. Company size shows the size of the company that can be seen from the total assets. Companies that have large assets tend to look for a relatively large PAF, because they want to get a better quality audit results. So it can be said that the larger the size of the company, it will look for large PAF to get quality audit results and add the company's good name (Ginting & Fransisca, 2014).
PAF size is also one of the factors that influence the PAF switching. PAF size is an indicator for companies to assess the quality of auditors. Most companies consider large PAFs have better auditor quality when compared to small PAFs. Large PAF become an indicator of audit quality in conducting audit assignments and opinions generated. PAF big four more qualified than PAF non big four (Sulistiarini, 2012; Salleh & Physical, 2014).

In addition, the company can make PAF switching caused by the opinion of the auditor, where the company always wants to get an unqualified opinion. If the company gets an opinion that is not in line with its expectations, such as getting a fair opinion with a qualified opinion, it will tend to initiate PAF switching on voluntary. This is because the company wants to get good opinion results, regardless of the condition of the company itself. Auditor opinion is one of the conditions to see the condition of the company, which can attract investors to invest in the company (Ginting & Fransisca, 2014; Wea & Murdiawati, 2015).

Literature Review

The Contracting theory

Watts & Zimmerman (1986) suggests that, in positive accounting research, theories of accounting practices and auditing practices have been developed, through economic theory which asserts that it is assumed that there is always nonzero contracting and information costs. That is, company managers need cash flow to create policies in determining accounting procedures and political policies for corporate activities. The need to contract between manager and shareholders (outside shareholders) by Jensen & Meckling (1976) stated that, in fact not a contract between the company with them but as agency relations. That is, the principal assigns or delegates to the agent (manager) to make a decision. So the contracts between managers are seen as agents and shareholders as principals. So it can be said that the role of accounting and auditing is very close in theory underlying. Watt & Zimmerman (1986) states that in order to reduce agency costs a contract is required to conduct monitoring of the company, namely auditing. The need for monitoring of accounting and explanations in auditing practice can be explained in contract theory. For example, explanations relating to the independence of the auditor, the existence of auditor professionalism, and the size of the Public Accounting Firm. Usually researchers use this theory to predict the company with its professionalism when the auditor is not required by law.

The contracting theory is used to describe the research in auditing practice, for example about the auditor or Public Accounting Firm (PAF) relating to the auditor's reputation, professionalism, auditor environment, PAF size, and industry specialization. PAF that has a large brand image is considered to have a better reputation when compared with small PAF, because large PAF is considered to have a reputation in maintaining the quality and independence. While small PAF has no more value, because small PAF is considered still under client pressure (Watt & Zimmerman, 1986), it is also supported by De Angelo (1981) which states that, large PAF is preferred by clients because large PAF is considered more independent rather than small PAF. Research related to auditing using contract variables has also been done by Chow (1982) to predict and explain the selection of PAF with a sample of 1926 companies, whether the company is audited or unaudited by a professional auditor. The variables used in the study are: 1) firm size, measured by market value of equity plus book value of debt; 2) capital structure, as measured by book value of debt and 3) Total debt. Chow explained that companies whose debt-to-equity ratios will tend to be more audited. The result of the research is that all independent variables are predicted to be significant. This is consistent with the contract theory that, this theory can support the potential for predicting auditing practices.

The Agency theory

In general, research in the field of auditing is built from the discipline of economics, psychology and the science of law. This field of auditing is considered a discipline that ignores theory, but some previous auditing studies have used agency theory as the theoretical basis for explaining the need for auditors as a bridge between the interests of agents and principals (Sila, 2016). The agency theory explains the agency relationship that occurs because of the contract of agreement between the agent and the principal, to perform the tasks that are in the interest of the principal. The difference in importance between the agent as the management of the firm and the principal as the owner of capital can occur in carrying out the agency relationship (Jensen & Meckling, 1976). Principal as the owner of the capital provides a mandate or authority to the agent to undertake and take decisions for the operational activities of the company, in accordance with agreements or contracts that have been agreed upon by both parties. The mandate granted to the agent to carry out the operations of the company, in accordance with the restrictions that have been determined.

To carry out the operational activities of the company well, the need for control of principals who do not give full confidence to the agent. This is because humanly the agent will gain personal gain over his work, so the principal always controls the work of the agent. The principal also has an interest in the operations of the company, so the relationship between the agent and the principal often creates a conflict of interest. This conflict of interest is because each individual wants his own advantage, which can lead to information asymmetry. The information asymmetry is the information difference between the agent's interest and the principal's interests. The financial statements presented by management as agents, lead to the existence of information asymmetry between agents and principals due to differences of interest. Therefore, an independent third party, the auditor, is required. So in the presentation of financial statements will get a balanced and accountable information (Halim, 2013).

Theoretical evidence of PAF switching on voluntary is based on agency theory, a theory that deals with contractual relationships between agents (management) and principals (share-holders). The principal as the owner of the capital gives trust to the agent to manage the assets of the company, and the agent has an obligation to provide reports on the development of the company each period. However, the relationship between the agent and the principal in the company's operational activities creates a conflict, so that a third party is needed, namely the independent auditor (Maulida, 2015).

Government Regulation of the Republic of Indonesia concerning the Public Accounting Firm or Auditor Switching

Pratini & Astika (2013) states that, the Government of Indonesia through the Decree of the Minister of Finance No.359 / KMK.06 / 2003 that the company must make the PAF switching on voluntary that has been assigned the audit for 5 consecutive years. Also explained by Wea & Murdiawati (2013) stating that, the decree was updated with the issuance of Regulation of the Minister of Finance No.17/PMK. 01/2008 on Public Accountant Services, article 3 paragraph 1 regarding the provision of general audit services to the financial statements of an entity can be done by the Public Accounting Firm no later than 6 consecutive years and by a Public Accountant for a maximum of 3 consecutive years. Later in Article 3, paragraph 2 and 3 it is stated that, Public Accounting Firm and Public Accountant may receive return of audit assignment to client after 1 year of book does not provide general audit service of client's financial statement same. Therefore, the Auditor shall maintain the quality and maintain its independence, as governed by the Regulation of the Minister of Finance. In the audit assignment, the auditor has a good relationship between the auditor and the company (the client) if the auditor cooperates in the long run. Through the Regulation of the Minister of Finance, the Public Accounting Firm (PAF) must make changes in the client within the stipulated time. According to Putri (2015), the Regulation of the Minister of Finance No.17 / PMK.01/2008 does not necessarily bind the effective behavior of PAF (auditor) in maintaining its independence. In practice, the PAF switching follows the rules stipulated by the Government, but there is also PAF switching beyond the time specified in the PMK.

PAF switching is a policy undertaken by the Government to maintain the independence of the auditor to the client. In some Southeast Asian countries or ASEAN, it also has a policy to maintain the independence of auditors in the PAF switching, including in Malaysia (Won, Teng, et al, 2014). In Malaysia there is also a rule regarding PAF switching if the PAF has been auditing the same client for more than 5 years. This rule is set by Malaysia Institute Accountant (MIA) on Professional Ethics, Conduct and Practice, section 290.151 (Salleh & Physics , 2014). The PAF switching is also required in Singapore, that the company must make a PAF switching if the company has more than 5 years cooperate in audit assignment (Koh, 2001). While research conducted by Ginting & Fransisca (2014) that, the influence of audit fee on the PAF switching, while PAF size, client size and opinion does not affect the PAF switching in Company listed in Bursa Malaysia. Borja's (2015) research reveals that PAF is replaced by property firms, financial institutions and the energy sector in the Philippines, where the results of the study suggest that auditor turnover is influenced by the size of the PAF and the credibility of the financial statements. Based on some research it can be seen that in some ASEAN countries also happened PAF switching caused by various factors.

The Public Accounting Firm Switching on voluntarily

PAF switching is the replacement of the auditor or PAF by the client. Audit turnover is also called by other terms auditor switching, it is mandatory (mandatory) or voluntary (voluntary). Compulsory PAF switching is PAF switching that should be done by the client due to the time limit stipulated by Regulation of the Minister of Finance of the Republic of Indonesia Number 17 / PMK.01 / 2008 regarding "Public Accounting Services". The regulation states that clients who have audited the same PAF for 6 consecutive years are required to make a PAF switching. (Princess and Nazar, 2015). It is expected that auditor independence can be maintained well, because the auditor is a third party that can give trust to users of financial information company (Agoes, 2004).

Previous research on the PAF switching has been done by Salleh & Jasmani (2014) that 156 companies listed on the Malaysian stock exchange in the year 2003-2012 stated that PAF non big four tends to give qualified opinion , as well as auditor opinion does not affect the PAF switching. While research conducted in Indonesia conducted by Suyono & Yi (2013) Size of PAF does not affect the PAF switching on voluntary. Woo & Koh (2010) research in Singapore states that firms that are audited by small firms tend to the PAF switching on voluntary, and companies with high leverage tend to PAF switching. From several studies it can be seen that the auditor's opinion and PAF Size does not affect the PAF switching on voluntary

Conclusion

In some countries through regulatory agencies have implemented their tian pergan PAF is mandatory, so fenomena is interesting to study because of the many factors that may affect the company's decision to make the the PAF switching on voluntary. Factors influencing the the PAF switching on voluntary are the client factor as well as the factor of the auditor. According to Won et al. (2014) states that research conducted in Malaysia about the PAF switching on voluntary is influenced by the auditor factor that is the complexity of the auditor's task and the auditor's risk level, while the client factor is the ownership level, the auditor fee and the going concern opinion. The results showed that the level of risk, ownership level, auditor fee and auditor's opinion significantly influenced the voluntary change of auditors. While the factor of the auditor is the size of PAF and the factor of the client that management turnover successfully supports the hypothesis, that the PAF and management turnover have an effect on the change of auditor. Other studies conducted by Hudaib & Cooke, 2005 , Poels, 2011, Sihotang, 2014, Khasharmeh, 2015, Suyono & Yi, 2013) state that competition between PAFs, audit fees, and auditor's opinion qualified influenced the client's decision to make a change HOOD. While the client's financial condition, PAF size, and management changes do not affect the change of PAF. Other studies show different results, Nasser et.al (2006) states that tests conducted on 297 companies listed on the Kuala Lumpur Stock Exchange exchanges over a period of 11 years that the PAF switching on voluntary is significantly related to the financial difficulty level of clients and PAF types. That is, companies that have financial difficulties will tend to move PAF so that the resulting opinion is better. PAF big four type factors tend to generate qualified opinion if the company is experiencing financial difficulties.

All of these studies use agency theory as the theoretical basis, which, according to the authors, this is not a purely agency theory as the role of agents and principals, but only limited to the role of auditors as monitoring. In this literature review found the theory that based on research in the field of appropriate auditing practice is contract theory, which states that the role of independent auditors as a party that performs monitoring between principals and agents, requires a contract management agreement with the shareholders. Because to do monitoring, it is impossible not to pay the cost. This is called in contracting theory.

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