International Journal of Economic Research

ISSN : 0972-9380

available at http: www.serialsjournal.com

Volume 14 • Number 12 • 2017

Effects of Auditor Quality on Market-based and Accounting-based Financial Statement Quality and Its Impacts on Economic Consequences (A Case on Indonesia Capital Market)

Abdul Nasser Hasibuan[1], Ade Fatma Lubis[2], Sirojuzilam Hasyim[3] & Isfenti Sadalia[4]

[1] Doctoral Accounting Programme of Faculty of Economic and Business, Universitas Sumatera Utara & Lecturer in IAIN Padang Sidempuan
[2,3,4] Faculty of Economics and Business, UniversitasSumatera Utara, Jl. Prof. TM Hanafiah No. 12 USU
Campus Medan-North Sumatera – Indonesia –Postal Code 20115
Correspondence email : E-mail.iainpaandgsidempuan@yahoo.com

Abstract: The present research was aimed to describe Effects of Auditor Quality on Market-based and Accounting Financial-based Statement Quality and its Impacts on Economic Consequences in Indonesia Stock Exchange. Samples used were companies incorporated in manufacturing companies listed on Indonesia Stock Exchange(IDX) in the period 2011-2015. The total samples were 100. The sampling method employed probability sampling with proportionate stratified random sampling technique. The analytical model used in this research was SEM (Structural Equation Modeling) where a statistical technique was capable of analyzing the pattern of relationships between latent constructs and the indicators; one latent construct and another; as well as direct error measurement. SEM allows direct analysis between several dependent and independent variables.This research found that auditor quality has significant effects on market-based and accounting-based financial statements. As for auditor quality variable on economic consequences, it has a significant effect. For the intervening effect of auditor quality variable on economic consequences, using market-based and accounting-based financial statement as intervening variables, it has a significant effect; where the contribution of market-based and accounting-based financial statements' quality is considerably greater than its direct effects.

Keywords: Auditor Quality, Market-based and Accounting-based Financial Statements and Economic Consequences.

A. INTRODUCTION

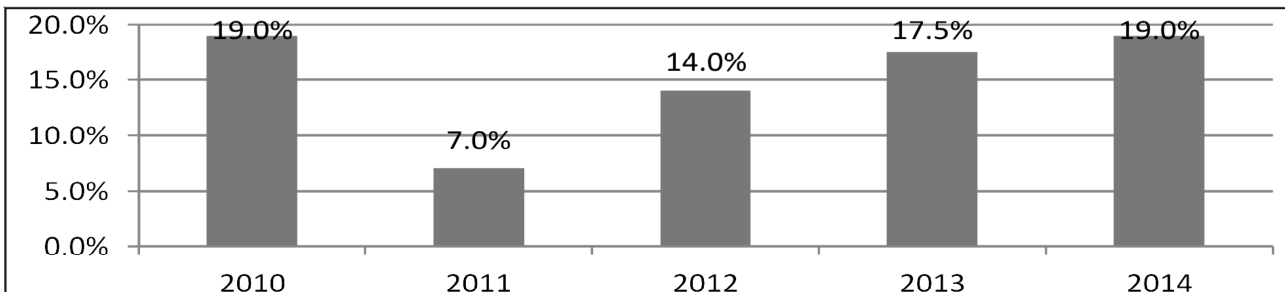
The increasing international business growth in many countries is also boosting financial reforms, particularly in terms of financial statement improvement of companies. Implementing international financial statement standards to company financial statements is expected to improve the financial statement quality. However, it remains unclear whether or not the reforms will improve the financial statement quality.

Ball and Brown (1968) said financial statement information is a crucial element for investors and business persons as a tool for decision making. The need for financial statement by management to shareholders is explained through agency theory. Jensen and Meckling (1976) in this theory illustrate the presence of contractual relationship between the manager (agent) and the owner of the company (principal). Upon this relationship, economic consequences happen, taking the form of information asymmetry due to conflict between agents and principals.

Quality information delivery will reduce the economic consequences in the form of information asymmetry (Cohen, 2003). In Indonesia, financial statement is viewed as crucial and significant problem to be observed by users of financial statements themselves – as financial statements are the final outcome of accounting activities. Financial statement has informational content as a consideration and is a source of information frequently used by investors in making decision (Lako, 2006).

Starting from the importance of quality financial statement, agency theory argues that company performance is influenced by conflict of interest between the agent and the company owner (Dalimunthe*et al.*, 2016). Such conflict of interest emerges from the opportunistic behavior of the agents who do not always act as expected and violate the contract agreed upon by taking advantage of the opportunity to use the information they know to manipulate financial statement, as an attempt to optimize their welfare (Jensen and Meckling, 1976 and Yahya*et al.*, 2017). In order to minimize the occurrence of such conflict, the auditor as the outside party is needed for authorization, in addition to corporate financial statement. They will eventually improve the quality and give an impact on economic consequences.

Empiric facts on corporate financial statement quality can be seen from audit opinions on the corporate financial statements. In Indonesia Stock Exchange, audit opinion other than unqualified is still commonly found, signaling many corporate financial statements in Indonesia Stock Exchange do not meet the statement standards. Below are the opinions of manufacturing companies at IDX:



Source: Processed Data from Bapepam/ Financial Service Agency (2015)

Figure 1: Fluctuation in Audit Opinion besides Unqualified Exceptional

Figure 1 shows that the Audit Opinion other than Unqualified of 141 manufacturing companies listed on Indonesia Stock Exchange in 2010 is 19% of companies of which audit opinion is unqualified; 7% in 2011, 14% in 2012, 17.5% in 2013, and 19.0% in 2014. The audit opinion indicates that there are still many low quality financial statements. In the opinion of Cohen (2003) and Fanani (2008), the low quality of financial statements will give economic consequences – by the increasing information asymmetry between the agents and principals. Nevertheless, it differs from the phenomenon occurring in the manufacturing sector on Indonesian Stock Exchange from 2011 to 2015. More details can be seen in the following Table:

Table 1
Statistics of Information Asymmetry of IDX Manufacturing Sector in 2011-2015

No.	*Sector Name*	*Year*				
		2011	*2012*	*2013*	*2014*	*2015*
1.	Basic industrial and chemical sector	39,24	37,01	33,73	28,40	25,89
2.	Various industries sector	42,09	40,18	43.65	34,17	28,46
3.	Consumer goods industry sector	36,36	37,39	36,64	25,37	21,71
	Total	117,69	114,58	114,02	87,94	76,06

Source: processed data from publication of financial report of IDX Companies (2016).

Table 1 above describes that information asymmetry measured using *bid ask spreads* between the agents and principals from 2011 to 2015, showing continuous decline. It is in contrast with audit opinion on corporate financial statements on Indonesian Stock Exchange that indicate low quality of financial statement. On the other hand, according to Regrigo (2006), the weak quality of corporate financial statement is followed by information asymmetry that will influence the investors' decision-making in doing their investment.

Starting from such phenomenon, financial statement is highly interesting to examine – as it is not in line with the existing theory which states that low quality of financial statement will increase information asymmetry. In this research, the financial statement quality is viewed based on market and accounting statements. Market-based statements include relevance, timeliness and conservatism, whilst accounting-based statement includes persistence, predictability and smoothing of earnings, and factors affecting the financial statement quality. According to Cohen (2003); Francis *et al.*, (2004), it consists of audit quality (the size of public accounting firm and audit specialization). The auditor quality serves to play an important role in the success of corporate system. In the opinion of De Angelo (1981), audit is a process of monitoring and improving information alignment embodied between the management and shareholders.

The research findings prove the importance of financial statement quality and there are many and varying factors affecting it, either in international or domestic research in Indonesia. For example the research results by Sartono (2001), Sembiring (2005), Fanani (2008), and Hidayat and Elisabet (2009). International-scale research on financial statement quality has been conducted by Cohen (2003), Regrigo (2006), Gery *et al.* (2009) and Katie (2011) in America, Feng *et al.* (2010) in China, and research carried out by Hassan and Bello (2013) in Nigeria, discussing the characteristics of companies on financial statement quality.

Based on this background, this research will discuss varying effects of auditor quality on financial statement quality which is based on market and accounting, and its impacts on the economic consequences - as an implementation of opportunistic theory, agency theory, and positive accounting theory. This research object was manufacturing companies listed on Indonesia Stock Exchange (IDX). It is because manufacturing companies in Indonesia include those with the highest growth in ASEAN (BPS, 2013).

Formulation of Problems

1. Does auditor quality have any effect on market-based and accounting-based financial statement quality?
2. Does auditor quality have any effect on economic consequences?
3. Does auditor quality have any effect on the economic consequences if market-based and accounting-based financial statement quality serves as intervening variables?

Research Benefits

1. For the company, it is expected to provide encouragement and ideas on good quality financial statement, especially in manufacturing industries listed on Indonesia Stock Exchange with different company characteristics and ownership.
2. For the government and investors, it is expected to contribute ideas for provision of guiandce on the quality of financial statement; protection for investors from harmful practices; prevention of information asymmetry & profit taking; and any other forms of violations.
3. For researchers, it is expected to improve their insight into the field being studies.

2. LITERATURE REVIEW

2.1. Theoretical Basis and Hypotheses Development

2.1.1. Agency Theory

The agency theory by Jensen and Meckling (1976) illustrates the contractual relationship occurred between the principals and agents when the authority and responsibility in decision-making are given to the agents. Eisenhardt (1985) explains that agency theory is the best way to organize a company, in which there is a contractual relationship between the owner and agent, and the owner determines the job while the agent executes it.According to Jensen and Meckling (1976), agency theory is a theory that describes agency relationships and problems it brings. Agency relationship is a relationship happening between principals and agents in doing transactions with the third parties, where the managers and investors have contrasting opinions in achieving company goals.This difference of opinion is caused by the conflict of interest as agency problem. Eisenhardt (1989) argues that agency conflict issues occur because the principals and agents use three basic human nature assumptions:

1) Humans generally put their self-interest first
2) Humans have a limited mindset on the future (bounded rationality)
3) Humans always avoid risks (risk adverse). This situation will trigger the emergence of a condition called information asymmetry.

2. 1.2. Opportunistic Theory

In the opinion of Maryono (2013), opportunistic behavior is a behavior that seeks to achieve desire by all means, even illegally. Meanwhile, opportunistic theory assumes that managers have self-interest in short term to form a poor corporate structure by managing earnings at a desired level according to their own interests (Klein, 2002). Maryono (2013) states that the factors that influence opportunistic behavior are power and ability; where opportunistic behavior leads to adverse selection (hiding information) and moral hazard (misuse of authority). There are two conditions used by the managers to bring opportunistic behaviors into reality (Gusnardi*et al.*, 2016). First, in the condition to increase their income so it can fulfill their self-interest in short term. Second, in the condition of self-interest in long term to be achieved (Garamfalvi, 1997).The occurrence of these opportunistic behaviors will lead to declining financial statement quality, which is caused by two elements: (1) noise, caused by aggressive management accounting policy; and (2) opportunistic financial statement behavior (Francis *et al*., 1999).

2.1. Hypotheses Development

2. 2.1. The Relationship between Audit Quality and Market-based and Accounting-based Financial Statements

The agency theory states conflict is happening between agents and principals because agents know more company information than principals. Agency theory also assumes that humans will always have self-interest, making the presence of an independent third party is highly needed to serve as a communicator between principals and agents. In this case is independent auditor, in order to reduce information asymmetry between management and shareholders. Another party needed is auditor to authorize financial statements (De Angelo, 1981).De Angelo (1981) points out large-scale auditing companies tend to better maintain their good name and reputation than smaller auditing companies. Clients audited by Big Four are shown to have higher accrual quality, typically-measured as absolute value is lower than discretionary-crucial (Francisetal, 1999). Meanwhile, the research conducted by Fanani *et al.* (2009) proposed positive and significant relationship with the quality of accounting-based financial statement for auditor quality variable. Christiani and Nugrahanti (2014) point out the research results that the KAP size does not affect financial statement quality.

On the other hand**,** Mayangsari (2004): financial statement quality with *brand name* audit and industry specialization results in increasing agency cost, allowing quality information. The research carried out by Craswell *et al.* (1995) suggests that the cross-sectional variation of company's specific factors in influencing agency costs widely ranges. Therefore, these differences require certain skills that commonly better detect difference.

H1: There are effects of auditor quality on market-based and accounting-based financial statement quality.

2.2.2. The Relationship of Market-based and Accounting-based Financial Statement Quality and Economic Consequences

The auditor's office has an important role to influence disclosure and authorize the company's annual report, affecting economic consequences in the form of equity capital costs to obtain information by investors. In the regulation issued by capital market watchdog, the company's annual report must be audited by auditor before being issued by the company (Sirojuzilam*et al.*, 2016). Benardi*et al.* (2009) said that auditors play an important role in improving company statement strategy in overall – as audited annual reports will serve as a basis for the investors in business decision making. The auditor quality being the factor that influences this research is the size of the public accounting company and the auditor specialist.

In general, the size of public accounting companies can be divided into two categories; the first is a public accounting company with global scope (*big four*), and public accounting company with domestic sphere or non big four. Benardi *et al.* (2009) argue the quality of auditors between large and small-size KAP certainly has differences in terms of resourcesand technology that can affect the work (quality) of audit. Cohen (2003) finds that positive relationship of high quality financial statement reduces the information asymmetry.According to Jensen and Meckling (1976), auditing is a process of monitoring and improving information alignment embodied between management and shareholders. This audit is expected to reduce errors in delivery of information contained in financial statements. Thereby, an independent party is required to authorize financial statement, called an auditor.

2.2.3. The Relationship of Auditor Quality and Economic Consequences with Market-Based and Accounting-based Financial Statement Quality as the Intervening Variable

Holthausen and Leftwich (1983) state the options of accounting methods will result in high and low level of financial statement which affect on the economic consequences. While Zeff (1978) said economic consequences are impacts on accounting statement to its users and decision-making behavior caused by the impact. Such impacts may come in the form of information asymmetry between the agents and capital owner; where asymmetry information is an imbalance condition of information between management as an information provider and the shareholders & stakeholders as information users in general (Fanani, 2009).

The research by Cohen (2003) refers to economic consequences with information asymmetry indicator, saying that high quality financial statement will reduce information asymmetry emerging between agents and shareholders. The research conducted by Copeland and Galai (1983) found that if accounting information quality increases, the information asymmetry will decrease. Diamond and Verrecchia (1991) state that information asymmetry may be reduced if the company implements broad financial statement policies.

H3: There are effects of auditor quality on economic consequences with market-based financial and accounting-based statement quality as the intervening variable.

3. RESEARCH METHODS

3.1. Type of Research

The research type was quantitative. Based on the characteristics of the problems being studied, this research can be classified into comparative causal research. According to Lutfie, *et al.,* (2016), Lubis, *et al* (2016, 2016), Muda, *et al* (2016, 2016), causal researchis those aimed to test the hypothesis and the research to explain the phenomenon in the form of relationship between variables. The main objective of this study is to identify causal relationship among various variables. In addition, it was included as quantitative research. Quantitative research emphasizes on the theoretical testing through the measurement of research variables using numbers and performing data analysis with statistical procedure (Tarmizi, *et al*, 2016, 2017).The research site was Indonesia Stock Exchange, conducted from January 2011 to December 2015.The data type used in this research was secondary data, namely finished data and require no further processing, obtained from the internet media via the site *http://www.jsx.co.id/* in the form of published financial statements of manufacturing companies.The population of this research was the target population of manufacturing companies listed on Indonesian Stock Exchanges from 2011 to 2015 that is averaged to equate the data on finance-based and accounting-based financial statement quality variable. The population was divided into three sectors (basic chemical industry, various industries and consumer goods industry) which possess data on auditor quality, financial statement quality and information asymmetry, amounted to 132 companies.

The determination of the total samples is based on Slovin formula (Husein, 2005 and Khaldun and Muda, 2014), with Slovin formula known n = 99.27 rounded to 100, making the research samples amounted to 100 companies. The sampling method used probability sampling with proportionate stratified random sampling technique, where the sample determination considers the strata (level) existing in the population – as this technique is commonly used in ketogenic (dissimilar) population being studied. In this case, it is different in work field so that the sample size in each strata or group is taken proportionally. According to Ferdinand (2014), in order to obtain the number of samples taken individually, the part is redefined by the formula below:

$$n = \frac{class\ population}{total\ population} \times \text{the number of samples specified}$$

From the formula, the distribution of sample size can be seen in the Table below:

Table 2
Total Research Samples

No	*Sector Name*	*Number of Companies*	*Number of Samples*	*Number of Samples*
1	**Basic Chemical Industry Sector**			
	Cement sub-sector	4	3,03	3
	Ceramic, porcelain and glass sub-sector	5	3,78	4
	Metal sub-sectors and alike	15	11,36	11
	Chemical sub-sector	9	6,81	7
	Plastic and packaging sub-sector	11	8,33	8
	Feed and livestock sub-sector	4	3,03	3
	Wood and its processing sub-sector	1	0,75	1
	Pulp and paper sub-sector	8	6,06	6
2	**Various Industries Sector**			
	Automotive and component sub-sector	12	9,09	9
	Textile and garment sub-sector	17	12,87	13
	Footwear sub-sector	1	0,75	1
	Cable sub-sector	5	3,78	4
	Electronics sub-sector	1	0,75	1
3	**Consumer Goods Industry Sector**			
	Food and beverage sub-sector	15	11,36	11
	Cigarette sub-sector	4	3,03	3
	Pharmaceutical sub-sector	11	8,33	8
	Cosmetics and household goods sub-sector	5	3,78	4
	Household appliances sub-sector	4	3,03	3
	TOTAL SAMPLES	132		100

3.5. Operational Definiton and Variable Measurement Method

Theoperationaldefinitionmatrix of each variable and itsmeasurementisshown in Table 3:

Table 3
Operational Definition of Research Variables

Name/Types of variables	*Definition of Variables*	*Parameter*	*Scale*
	Dependent Variables		
1. Quality of Financial Statement based onIndicator Market	Representation of the accuracy of Financial Statement based onIndicator Market	Scores of relevance, timeliness and conservatism (Fanani*et al*,. 2009)	Ratio
1.Relevance	The financial statement information resulted may influence the users and uses the estimation data for five years	The negative value of adjusted R2 of the following equation $RET_{jt} = \beta_o Earnings_{jt} + \beta_1 \Delta Earnings_{jt} + \varepsilon_{jt}$ $Relevance = -R^2_{jt}$ (Francis *et al.*, 2004) RET_{jt}= rewards for 15 months that ends after the last three months of fiscal year in j company in year t $Earnings_{jt}$= net profit of j company in t year $\Delta Earnings_{jt}$= difference in net income of j company in year t-1	Ratio
2.Timeliness	The information is presented in a timely manner and uses the estimation data for five years	The negative value of adjusted R2 regression of the following equation $Earnings_{jt} = \beta_{oj} + \beta_1 NEG_{jt} + \beta_2 RET_{jt} + \beta_3 NEG_{jt} RET_{jt} + \varepsilon_{jt}$ $Timelines = -R^2_{jt}$ (Francis *at al.*, 2004) $Earnings_{jt}$= net profit of j company in year t RET_{jt}= rewards for 15 months that ends after the last three months of fiscal year in j company in year t. NEG_{jt}=Dummy variable 1 for RET<1 andanother 0	Ratio
3.Conservatism	The similarities and differences between the two sets of economic phenomena and usesthe estimation data for five years	The value of *fixed effect* of the following equation multiplied by–1as as proxy of market-based conservatism $BTM_{jt} = \beta + \beta_j + \beta_t + \sum_{k=0}^{6} \beta_k R_{jt-k} + Ejt$ (Ahmad *et al.*, 2008) BTM_{jt} = ratio of book value to market value of j company in fiscal year ending at t β =intercept of the whole company and the entire year β_i= specific company bias components fixed at the ratio of book value to market value (BTM) during the sample period. β_t= the ratio component of book value to market value in certain years for the entire company R_{jt-k} = Stock Return (excluding dividend) for j company in year t.	Ratio
2.Quality of Financial Statement based onIndicator Market Indicator : 1. Persistence	Representation of accuracy of accounting-based financial statement	Score of persistence, predictability, and smoothing of earning (Fanani*el al*,. 2009)	Ratio
	Revised earnings will come as a result of implication of current year earnings and uses the estimated data for five years	The regression coefficient of equation : $\frac{earning_{jt}}{outstandingshares_{jt}} = \beta_0 + \beta_1 \frac{earning_{jt-1}}{outstandingshares_{jt-1}} + E_{jt}$ (Fanani*et al*,. 2009) $Earnings_{jt}$= net profit of j company of year t Earningsjt-1=earning before extraordinary items of j company in the previous year Outstanding $shares_{jt}$= outstanding shares of j company in year t	Ratio

2. Predictability	Past earnings ability to predict future earnings and use estimation data for five years	Variant root error of the equation: $\frac{earning_{jt}}{outstandingshares_{jt}} = \beta_0 + \beta_1 \frac{earning_{jt-1}}{outstandingshares_{jt-1}} + E_{jt}$ (Fanani*et al*,. 2009) $Earnings_{jt}$= net profit of j company in year t Earningsjt-1= earnings before extraordinary items of j company in the previous year Outstanding $shares_{jt}$= outstanding shares of j company in year t	Ratio
3. Smoothing of earning	Efforts to normalize earnings at the desired level and use the estimation data for five years	Smoothing of earnings$\frac{^{\delta}NIBE_{jt}}{^{\delta}CFO_{jt}}$ (Fanani*et al*,. 2009) $NIBE_{jt}$ =net profits of j company in year t CFO_{jt} = $Aoperatingcashflowofjcompanyinyeart$	Ratio
3. Indicators of Economic Consequences:	The impacts of choosing accounting method	Unobserved	
1. Information asymmetry	The condition showing thathalf of investors who have information while others do not.	Spreadjt = askjt – bidjt X 100 % (askjt+bidjt)/2 (Cohen, 2003) Askjt = The highest demand price of j company's shares occurred in year t Bidjt = the highest offer price of j company's shares occurred in year t	Ratio
2. Capital Cost Equity	The costs incurred to finance the funding source	$r = (B_t + X_{t+1} - P_t) / P_t$ (Cohen, 2003) Pt = stock price in period t Bt = book value per share in period t X_{t+1}= price per share in period t	Ratio
Independent Variables			
Auditor Quality	Whether or not the audit implemented by the company is good - by judging the audit's systematic process	Unobserved	
Indicator			
1. KAP Measure	The Big Four scale of KAP, issued by Accounting and Appraisal Development Center (PPAJP) based on income: 1 KAP Tanudiredjawibisana &partners 2 KAP Purwantono, Sarwoko, andSandjaja 3 KAP Osman Bing Satrio& partners. 4 KAP Siddharta, andWidjaja	LN the big scores of KAP Score 5 forKAP Tanudiredjawibisana &partners Score 4 forKAP Purwantono, Sarwoko, andSandjaja Score 3 forKAP Osman Bing Satrio& partners. Score 2 forKAP Siddharta, andWidjaja Score 1 for KAP *non big four* (PPAJP.Kemenkeu.go.id)	Ratio
2.Spesialisasi Industri Auditor Industry Specialization	Specialization by looking at the market share of total assets and the number of company's clients audited by KAP in particular industry	SPEC= $\frac{totalclientsofKAPinindustry}{totalissuersinindustry} x \frac{averageassetsofclientsinindustry}{averageofclientsassetsinindustry}$ (Gul*et al*., 2009)	Ratio

3.7. Data Analysis Techniques

The data analysis used in this research was conducted by testing the relationship with SEM (Structural Equation Model) analysis technique to be analyzed using structural equation modeling assistance tool with alternative method Partial Least Squareusing software Smart PLS 2.0.

4. RESULTS

4.1. Measurement Model Development

4.1.1. Latent Variable Measurement Model on Auditor Quality

The auditor quality consists of 2 (two) indicators and each factor's weight in reflecting auditor quality variable:

Table 4
Factor Weight of Each Indicator of Auditor Quality Variable

Indicator	*Loading Factor*	R^2	T_{count}
KAP Measure	0,872	0,761	23,103
Auditor Industry Specialization	0,932	0,868	67,504
Composite reliability(CR)= **0,898**			
Average Variance Extracted(AVE) = **0,814**			

Source: Output Smart PLS (2017).

Based on Table 4, it can be seen that the value of factor weight for each indicator is greater than 0.5. The test result also obtains t_{count} value greater than the critical value of 1.96. The data show that both indicators significantly reflect latent variables of auditor quality. The value of Composite Reliability (CR) for the latent variable of auditor quality is 0.898, showing the conformity level of indicator in reflecting latent variable of auditor quality greater than recommended by 0.70. The Average Variance Extracted (AVE) value of 0.814 demonstrates that on average of 81.4%, the information contained in both indicators can be reflected by the latent variable of auditor quality. Between these two indicators, the auditor industry specialization is stronger in reflecting the latent variable of auditor quality in comparison with KAP measure.

It can also be seen from the path diagram of 2 (two) indicators and factor weight of each indicator of the auditor quality:

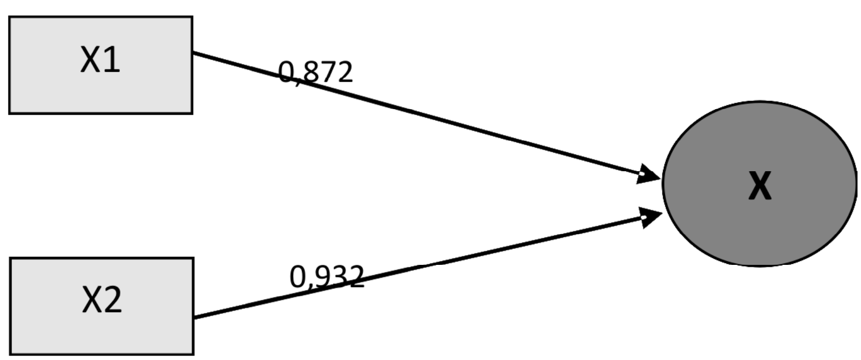


Figure 2: Path Diagramof the Auditor Quality Variable

Based on the Figure 2, the path diagram of auditor quality variable, the contribution of public accounting company size is 0.939, and auditor specialists at 0.926 on the structure's characteristics. All of these positive contributions demonstrate direct relationship on the auditor quality.

4.1.2. Latent Variable Measurement Model on Market-based Financial Statement Quality

The market-based financial statementwhich consists of 1 (one) indicator and eachindicator's factor weight in reflecting market-based financial statement quality variableis below:

Table 5
Factor Weight of Each Indicator of Market-based Financial Statement Quality Variable

Indicator	*Loading Factor*	R^2	T_{count}
Market-based financial statements	1,000	1,000	-
Composite reliability(CR)= 1,000			
Average Variance Extracted(AVE) = 1,000			

Source: Output Smart PLS (2017).

Based on Table 5, it can be seen that the factor weight value, CR and AVE is 1,000 because the market-based financial statement quality variable is described by one indicator.

4.1.3. Latent Variable Measurement Model on Accounting-based Financial Statement Quality

The accounting-based financial statement quality consists of 1 (one) indicator and eachindicator's factor weight in reflecting market-based financial statement quality variableis below:

Table 6
Factor Weight of Each Indicator of Accounting-based Financial Statement Quality Variable

Indicator	*Loading Factor*	R^2	T_{count}
Accounting-based financial statement	1,000	1,000	-
Composite reliability(CR)= **1,000**			
Average Variance Extracted(AVE) = **1,000**			

Source: Output Smart PLS (2017).

Based on Table 6, it can be seen that the factor weight value, CR and AVE is 1,000 because the accounting-based financial statement quality variableis described by one indicator.

4.1.4. Latent Variable Measurement Model on Economic Consequences

The economic consequences consist of 2 (two) indicators and eachindicator's factor weight in reflecting economic consequences is below:

Table 7
Factor Weight of Each Indicator of Economic Consequences Variable

Indicator	*Loading Factor*	R^2	T_{count}
Information asymmetry	0,944	0,891	70,255
Capital Cost Equity	0,837	0,700	9,079
Composite reliability(CR)= **0,886**			
Average Variance Extracted(AVE) = **0,796**			

Source: Output SmartPLS (2017).

Based on Table 7 above, it can be seen that all the value of factor weight for each indicator is greater than 0.5, and the result of the testing obtains t_{count} value greater than the critical value of 1.96. These data show both indicators significantly reflect latent variable of economic consequences.The value of Composite Reliability (CR) for the latent variable of economic consequences is 0.898, showing the conformity level of indicator in reflecting latent variable of economic consequences greater than recommended by 0.70. The Average Variance Extracted (AVE) value of 0.796 demonstrates that on average of 79.6%. The information contained in both indicators can be reflected by the latent variable of economic consequences. Between these two indicators, the information asymmetry is stronger in reflecting the latent variable of economic consequences in comparison with equity capital cost.

It can also be seen from the path diagram of 2 (two) indicators and factor weight of each indicator of the auditor quality:

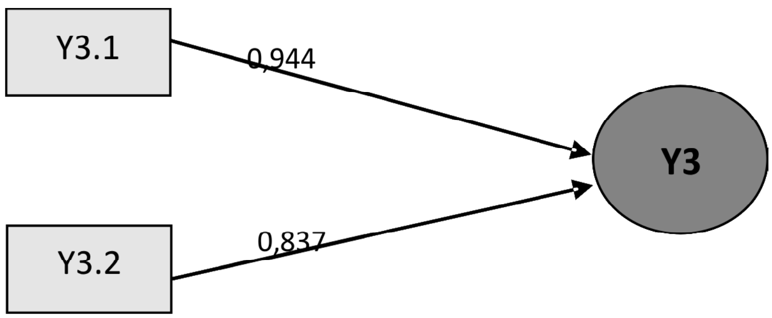


Figure 3: Path Diagramof Economic Consequences Variable

Based on the Figure 3, the path diagram of economic consequences variable, the contribution of asymmetry information is 0.944, and equity capital cost is 0.926 on the economic consequences. All of these positive contributions demonstrate unidirectional relationship of the economic consequences. From the measurement model of this research, it can be concluded that all the indicators of variables are acceptable and are able to explain the variables.

4.2. Hypothesis testing

1. *Effects of Auditor Quality (X) on Market-based Financial StatementQuality (Y1)*

The hypothesis to be tested is the effect of auditor quality on market-based financial statement qualityusing formulation of statistical hypothesesas follows.

H_0 : The auditor quality does not affect market-based financial statement quality at manufacturing companies in Indonesia stock exchange.

H_1: The auditor quality affects market-based financial statement quality at manufacturing companies in Indonesia stock exchange

Table 8
Test Result on Effects of Auditor Quality on Market-based Financial Statement Quality

Path coefficient	T_{count}	*p-value*	H_0	H_1
0,290	2,661	0,009	accepted	rejected

Source: Output SmartPLS (2017).

Based on Table 8, it can be seen that t_{count} value of auditor quality path on market-based financial statement quality is 2.661 with probability value of 0.009. Since the t_{count} value (2,661) is greater than that of $t_{critical}$ (1.96), therefore at 5% error rate, it is decided to reject $H_{0,}$ and accept H_1. Thereby, based on the test results, it is concluded that the auditor quality affects market-based financial statement quality.The path coefficient is 0.290 and is positively-marked. Therefore, it can be concluded that auditor quality has a direct relationship with market-based financial statement quality. That is, higher auditor quality will improve the market-based financial statement quality.

2. *Effects of Auditor Quality (X) on Accounting-based Financial Statement Quality (Y2)*

The hypothesis to be tested is the effect of auditor quality on accounting-based financial statement qualityusing formulation of statistical hypotheses as follows.

H_0 : The auditor quality does not affect accounting-based financial statementquality at manufacturing companies in Indonesia stock exchange.

H_1: The auditor quality affects accounting-based financial statementquality at manufacturing companies in Indonesia stock exchange.

Table 9
Test Result on Effects of Auditor Quality on Accounting-based Financial Statement Quality

Path coefficient	T_{count}	*p-value*	H_0	H_1
0,328	2,931	0,004	Rejected	Accepted

Source: Output SmartPLS (2017).

Based on Table 9, it can be seen that t_{count} value of auditor quality on accounting-based financial statement of 2.931 with probability value of 0.004. Since t_{count} value (2,931) is greater than that of $t_{critical}$ (1.96), therefore at 5% error rate, it is decided to reject $H_{0,}$ and accept H_1. Thereby, based on the test results, it is concluded that the auditor quality affects accounting-based financial statement quality.The path coefficient is 0.328 and is positively-marked. Therefore, it can be concluded that auditor quality has a direct relationship with accounting-based financial statement quality. That is, higher auditor quality will improve the accounting-based financial statement quality.

3. *Effects of Auditor Quality (X) on Economic Consequences (Y3)*

The hypothesis to be tested is the effect of auditor quality on economic consequencesusing formulation of statistical hypotheses as follows.

H_0 : The auditor quality does not affect economic consequences at manufacturing companies in Indonesia stock exchange.

H_1: The auditor quality does not affect economic consequences at manufacturing companies in Indonesia stock exchange.

Table 10
Test Result on Effects of Auditor Quality on Economic Consequences

Path coefficient	T_{count}	*p-value*	H_0	H_1
0,208	2,104	0,038	Rejected	Accepted

Source: Output SmartPLS (2017).

Based on Table 10 above, it can be seen that t_{count} value of auditor quality on economic consequences is 2.931 with probability value of 0.038. Since t_{count} value (2.104) is greater than that of $t_{critical}$ (1.96), therefore at 5% error rate, it is decided to reject $H_{0,}$ and accept H_1. Thereby, based on the testing results, it is concluded that auditor quality affects economic consequences. The path coefficient is 0.208 and is positively-marked. Therefore, it can be concluded that auditor quality has a direct relationship with economic consequences. That is, higher auditor quality will improve economic consequences.

4. *Effects of Market-based Financial Statement Quality (Y1) on Economic Consequences (Y3)*

The hypothesis to be tested is the effectof market-based financial statement quality on economic consequencesusing formulation of statistical hypotheses as follows.

H_0 : Market-based financial statement quality doest not affect economic consequences in manufacturing companies in Indonesia stock exchange

H_1: Market-based financial statement quality affects economic consequences in manufacturing companies in Indonesia stock exchange

Table 11
Test Result of Effects of Market-based Financial Statement Quality on Economic Consequences

Path coefficient	T_{count}	*p-value*	H_0	H_1
0,042	0,137	0,891	Accepted	Rejected

Source: SmartPLS Output (2017).

Based on Table 11, it can be seen that t_{count} value of market-based financial statement path on economic consequences is 0.137 with probability value of 0.891. Since t_{count} value (0.137) is smaller than that of $t_{critical}$ (1.96), therefore at 5% error rate, it is decided to accept $H_{0,}$ and reject H_1. Thereby, based on the test results, it is concluded that market-based financial statement quality does not affect economic consequences. The path coefficient is 0.042 and is positively-marked. Therefore, it can be concluded that market-based financial statement quality has direct relationship with economic consequences. That is, higher market-based financial statement quality will improve economic consequences.

5. *Effects of Accounting-based Financial Statement Quality (Y2)on Economic Consequences (Y3)*

The hypothesis to be tested is the effectof accounting-based financial statement quality on economic consequencesusing formulation of statistical hypotheses as follows.

H_0 : Accounting-based financial statement quality doest not affect economic consequences in manufacturing companies in Indonesia stock exchange

H_1: Accounting-based financial statement quality affects economic consequences in manufacturing companies in Indonesia stock exchange

Table 12
Test Result of Effects of Accounting-based Financial Statement Quality on Economic Consequences

Path coefficient	T_{count}	*p-value*	H_0	H_1
0,338	1,480	0,142	Accepted	Rejected

Source: SmartPLS Output (2017).

Based on Table 12, it can be seen t_{count} value of accounting-based financial statement path on the economic consequences is 1.480 with probability value of 0.142. Since t_{count} value (1.480) is smaller than that of $t_{critical}$ (1.96), therefore at 5% error rate, it is decided to accept $H_{0,}$ and reject H_1. Thereby, based on the test results, it is concluded that accounting-based financial statement quality does not affect economic consequences. The path coefficient is 0.338 and is positively-marked. Therefore, it can be concluded that accounting-based financial statement quality has direct relationship with economic consequences. That is, higher accounting-based financial statement quality will improve economic consequences.

(B) Testingon Intervening Variables

The testing on intervening variables in this research is the effects of auditor quality on economic consequences using market-based and accounting-based financial statement quality as intervening variables as seen below:

Table 13
Testing on Intervening Variables

Relationship	*Direct effects*	*Indirect effects*		
		Through Y1	*Through Y2*	*Total effects*
X -> Y1	0,290	-	-	0,290
X -> Y2	0,328	-	-	0,328
X -> Y3	0,208	0,012	0,111	0,331
Y1 -> Y3	0,042	-	-	0,042
Y2 -> Y3	0,338	-	-	0,338

Source: SmartPLS Output (2017).

Based on the calculation presented in Table 13, it is known that the direct effect of auditor quality (X) on economic consequences (Y3) is 0.208. Indirect effect through market-based financial statement quality

(Y1) is 0.012 (0.290x0.042) and indirect effect through accounting-based financial statement quality (Y2) is 0.111 (0.328x0.338). Therefore, the total effect of 0.331 is obtained. It shows that effect of auditor quality (X) on economic consequences (Y3) after being mediated by market-based financial statement quality variable (Y1) and accounting-based financial statement quality (Y2) is higher than the immediate effect. Therefore it is can be concluded that market-based financial statement quality (Y1) and accounting-based financial statement quality (Y2) give positive contribution in the relationship between auditor quality (X) on economic consequences (Y3).

5. DISCUSSIONS

5.1. Effects of Auditor Quality on Market-based and Accounting-based Financial Statement Quality

Partially, effects of auditor quality on market-based financial statement quality can be seen from the t_{count} value of auditor quality path on the market-based financial statement of 2.661 with probability value of 0.009. Because the t_{count} value (2.661) is greater than that of $t_{critical}$ (1.96), at 5% error rate, it can be concluded that auditor quality affects market-based financial statement quality. These results are similar to the auditor quality on accounting-based financial statement quality that can be seen from t_{count} value of auditor quality path on accounting-based financial statement quality at 2.931 with a probability value of 0.004. Since the t_{count} (2,931) value is greater than that of $t_{critical}$ (1.96) at 5% error rate, it can be concluded that auditor quality affects the accounting-based financial statement quality.

These findings are in line with research by De Angelo (1981), Hidayat and Elisabet (2008) and Fanani *et al.* (2009) said that auditor quality has positive and significant effects on financial statement quality as auditor credibility plays highly important role in establishing financial statement quality. In this research, the ones becoming manifest variables (indicator) are the auditor office size variable and auditor specialization variable. Meanwhile the research conducted by DeAngelo (1981) and Fanani *et al.* (2009) proposes that there is a positive and significant relationship in accounting-based financial statement quality. It is because the company wants their financial performance to look good in the eyes of investors, and they ignore the financial statement quality. In addition, rather than improving the financial statement quality, the presence of the Big-4 auditor is to improve the credibility of financial statements. Auditor industry specialization has more knowledge on particular industry. The ability of the auditor industry specialization to detect errors and maintain their reputation as auditors will encourage improvement in financial statement quality. Meanwhile, these findings contradict Christiani and Nugrahanti's (2014) who found the results showing that the size of KAP has no effect on earnings management. Auditor industry specialization negatively affects the earnings management.

5.2. Effects of Auditor Quality on Economic Consequences

Partially, effects of auditor quality on economic consequences can be seen from the t_{count} value of auditor quality path on economic consequences of 2.104 with probability value of 0.038. Because the t_{count} value (2.104) is greater than that of $t_{critical}$ (1.96), at 5% error rate, it can be concluded that auditor quality affects economic consequences. These findings support the agency theory by Jensen and Meckling (1976): auditing is a process of monitoring and improving the information alignment, manifested between the management and shareholders. These results support the research conducted by Gumanty (2012), stating that with these results, the selection of accounting techniques can reduce or increase income. It highly depends on the reasons or motivation of the person in charge of financial statement-making. The accounting technique or method may affect the performance of company finance that will affect the economic consequences. Involving quality auditors to authorize financial statements will generate positive impacts to reduce economic consequences in the form of information asymmetry and equity capital cost.

5.3. Effects of Market-based and Accounting-based Financial Statements on Economic Consequences

For effects of market-based financial statement quality on the economic consequences, it can be seen from the value of market-based financial statement quality on economic consequence at 0.137 with probability value of 0.891. Since the t_{count} value (0.137) is smaller than that of $t_{critical}$(1.96), at a 5% error rate, it is concluded that market-based financial statement quality has no effect on economic consequences. The result is similar to the effect of accounting-based financial statement on economic consequences can be seen from t_{count} value of accounting-based financial statement quality on the economic consequence of 1.480 with probability value of 0.142. Since the t_{count} (1,480) is smaller than the $t_{critical}$ (1.96), at a 5% error rate it is decided to accept H_0 and reject H_1. Thereby, based on the test results, it can be concluded that accounting-based statement quality and market does not affect economic consequences.

The results of this research are in line with the research by Apriliani (2012), Santoso (2012) and Cahyo (2014), finding that financial statement quality do not affect on information asymmetry. It is because investors in Indonesia in their decision-making have not been fully based on financial data, but some of them are also influenced by non-financial data and the environment. Natapura (2009) mentions three types of investors in the decision-making: (1) *intuitive type*, the type in decision-making which is based on instinct; (2) *emotional type*, the type in the decision-making which is based on emotion and rationality; and the type in decision making which is based on *a reason behind something*. The result is also evidenced by the number of investments in Indonesia which is increasing per year. For more details, it can be seen in Figure 4.

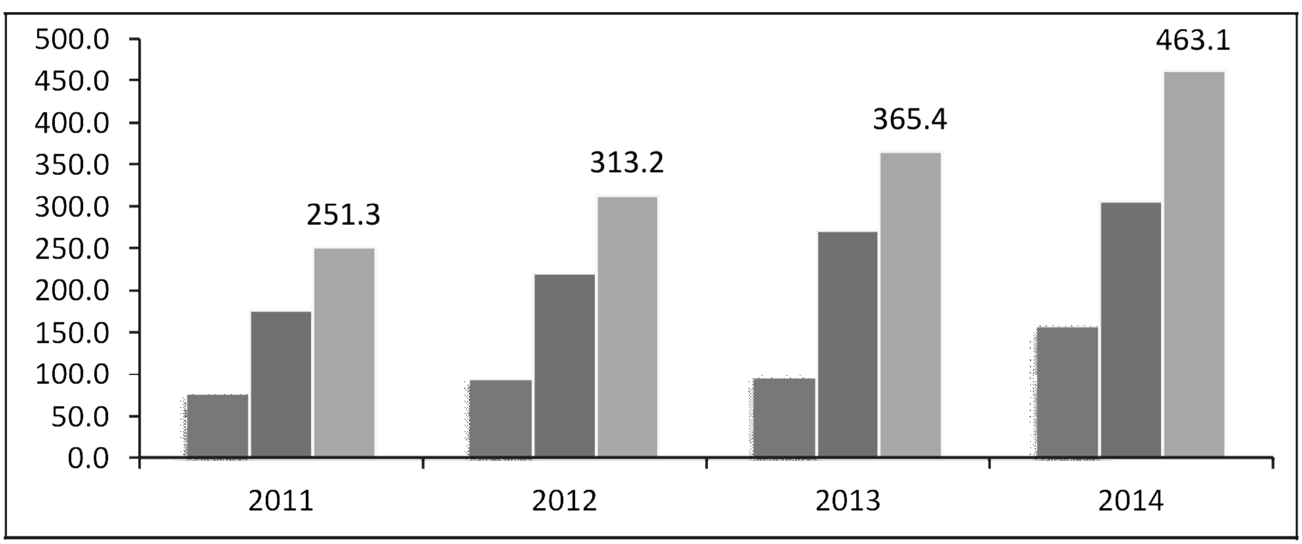


Figure 4: Fluctuation in the Number of Foreign Investment in Indonesia

Meanwhile, the findings of this research are close to the work of Indriani and Khoiriyah (2010), indicating insignificant positive effect between financial statement quality and information asymmetry. It is evident that despite the high quality of financial statement, the information contained therein is not always perfectly grasped by the users; and the lack of information obtained from financial statements will not necessarily trigger information asymmetry and equity capital cost. On the other hand, the findings are also close to the results of the research conducted by Fanani (2008) where the financial statement quality has a significant negative effect on economic consequences - information asymmetry. This difference may be resulted from the measurement of different financial statement quality.

These findings are not in line with the research conducted by Cohen (2003) who finds positive relationship that high quality financial statement has reduced the information asymmetry. It happens because of investor demand for company-specific information and financial statement quality with higher ownership cost (Nurzaimah*et al.*, 2016). This difference is due to the removal of several variables used as a proxy for financial statement quality; hence, even if the effect is negative, it is non-significant.

5.4. Effects of Auditor Quality on Economic Consequences through Market-based and Accounting-based Financial Statement Quality

Based on the calculation presented in table 4.10, it is known that the direct effect of auditor quality (X) on economic consequences (Y3) is 0.208. Indirect effect through market-based financial statement quality (Y1) is 0.012 (0.290x0.042) and indirect effect through accounting-based financial statement quality (Y2) is 0.111 (0.328x0.338). Therefore, the total effect of 0.331 is obtained. It shows that effect of auditor quality (X) on economic consequences (Y3) after being mediated by market-based financial statement quality variable (Y1) and accounting-based financial statement quality (Y2) is higher than the immediate effect. Therefore, it can be concluded that market-based financial statement quality (Y1) and accounting-based financial statement quality (Y2) give positive contribution in the relationship between auditor quality (X) on economic consequences (Y3).

6. CONCLUSIONS

Based on the data analysis and discussions conducted in the previous chapter, several conclusions produced in this research are:

1. Auditor quality variable has significant effect on market-based and accounting-based financial statements.
2. Auditor quality variable affects economic consequences.
3. For effects of auditor quality variable on economic consequences with market-based and accounting-based financial statement as the intervening variable; it has a significant effect, in the way that the contribution of market-based and accounting-based financial statement quality is considerably large in comparison with its direct effects.

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