The Structure of Malaysian Audit Market: From 2008 to 2010

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Abstract

The purpose of this study is to provide updated knowledge and detail on the structure of Malaysian audit market in the pre and post Audit Oversight Board (AOB) establishment. This study includes all Malaysian listed companies from 2008 to 2010. The examination of audit market structure was based on rate of audit fee per unit of size, audit market concentration and individual firm's market share. The results suggest Malaysia audit market can be described as tight oligopoly and there is slight changes in the market during the period 2008 – 2010. The noted changes are reduction of audit supplies and the increment of audit fee. The results suggest evidence of economic of scale enjoyed by big size companies. It is interesting to note that, while Big Four are now reducing the number of audit clients, they instead are focusing on larger clients. Focusing on big size companies possibly indicates a strategic move to avoid risky clients. Ernst & Young and PricewaterhouseCoopers are the most influential among Big Four firms, meanwhile Crowe Horwath as non-Big Four firms, is enlarging its market share.This study contributes to the audit market literature addressing the strategy adopted by audit firm in low litIgation risk environment. The study also examines the market power of non-Big Four firms in a developing country which is rarely investigated.

Keywords: Auditmarket, Big Four, market concentration, audit fee, audit quality

Introduction

In Malaysia, study on auditor switching suggest that about 300 companies switched auditors from 1990 to 2008 (Syed Mustapha Nazri, Smith & Ismail, 2012).Meanwhile, earlier study by Joher et al. (2000) found 135 auditor switchings from 1986 to 1996.Even though the average switching rate per year is small, theincidence of switching indicates misalignment of auditor-client relationship in the market.

Due to the dynamics of business nowadays, couple with a series of unpredicted economic crisis, the pattern of the audit market continues to changes (Hogan & Martin, 2009). Several factors contributing to changes in the Malaysian audit market structure. For example, increased public scrutinisation against the auditor, amendment of business rules and regulations, and establishment of Audit Oversight Board (AOB). However, only a limited number of studies examine the audit market structure in light of the above development. The purpose of this study is, therefore, to provide updated knowledge and detail on the audit market structure. Prior studies on Malaysian audit market were only conducted up to the year 2003 (Rahmat & Iskandar, 2004; Md. Ali et al. 2008; Ishak, Mansor & Sutan Maruhun, 2013). Since then, no detailed study was carried out.

Malaysia is included as a setting to achieve the research objectives due to relatively low market share of the large audit firms as compared to English speaking countries (Hope et al., 2008; Yaacob & Che-Ahmad, 2012; Ferguson & Scott, 2014). With high percentage of companies hire non-Big Four firms an examination on fee differences across auditor types could be carried out (Carson et al. 2007). Second, Malaysia was regarded as a country with

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less effective legal institutions and limited scrutiny on audit firms (Johl, Jubb & Houghton, 2007).

The study contributes to auditing literature by providing an insight into difference strategy adopted by various types of auditors in strengthening their market power. For instance, Ireland and Lennox (2002) demonstrate that in a setting where fee premium is high, large audit firms are able to attract high quality companies, therefore resulting in less audit effort and low audit fees. However, whether higher quality auditor could attract good clients in Malaysia, where the fee premium is low and litigation risk is uncommon remains unanswered.

Malaysian audit market

The dominance of large audit firms (i.e. Big Four that consist of Ernst & Young, Deloitte, KPMG, PricewaterhouseCoopers or PwC) in the audit market is reflected by high percentage share in the market. In general, there are two measurements of audit market structure being employed by Malaysian's studies. The following section discusses prior studies based on the type of measurement employed, namely number of audits and audit fees.

Number of audits

Table I presents big firms' market share based on number of audits.

Table I
Large audit firms' market share from 1991 to 2003, 2005 and 2007

Author(s)/Year	Year of study	Sample size	% of share (number of audits)
Mohd Iskandar, Maelah and Aman (2000)	1991	290	58.7
Mohd Iskandar et al. (2000)	1992	324	59.9
Mohd Iskandar et al. (2000)	1993	328	63.5
Mohd Iskandar et al.(2000)	1994	354	63.8
Mohd Iskandar et al. (2000)	1995	363	66.9
Mohd Iskandar et al. (2000)	1996	278	65.1
Hariri, Abdul Rahman and Che Ahmad (2007)	1997	611	73
Hariri et al. (2007)	1998	657	72
Hariri et al. (2007)	1999	678	73
Rahmat and Mohd Iskandar (2004)	2001	679	65.4
Che Ahmad, Shafie and Mohamad Yusof (2006b)	2002	819	73
Yatim, Kent and Clarkson (2006)	2003	736	68.8
Johl, Subramaniam and Mat Zain (2012)	2005	559	68.5
Rusmin et al. (2009)	2007	105	62

Notes:
1. Study on large audit firms' market share in Malaysia for 2004 and 2006 could not be identified.
2. Yaacob and Che-Ahmad (2012) covered the study between 2004 to 2008 and they only disclosed the average market share of Big Four firms (i.e. 65.2%).

Table I indicates that on average, big audit firms audited about 67% of total Pubic Listed Companies (PLCs). Also, big firms have consistently dominated Malaysian audit market share since 1991, with the lowest share being 58.7% (1991) and the highest at almost 74% (2005). From 1991 to 1997, Ernst &Young had the highest number of market shares (Mohd Iskandar et al., 2000; Hariri et al., 2007). However, in 1998, two other firms (Arthur Andersen and KPMG) also had similar percentage of audit market share (16%) with

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Ernst & Young (Hariri et al., 2007). Following the merger of Price Waterhouse with Coopers & Lybrand, three audit firms had the highest number of audits (17%) for the year 1999, namely, Ernst & Young, PwC and KPMG. The above table also shows that after the demise of Andersen, two out of three studies reveal large audit firms' market shares have been reduced. This implies that the demise of Andersen had a negative impact on the selection of large audit firms as companies' external auditor.

Audit fees

The next table shows the average audit fees paid by the listed companies to their external auditor.

Table II
Average audit fees paid by Malaysian listed companies

Authors/(Year)	Period of study (sample size)	Audit fees (RM)
Che Ahmad, Houghton and Mohamad Yusof (2006a)	1993 to 1995 (1149 companies)	140,870*
Hariri et al. (2007)	1997 (611 companies)	191,437
Hariri et al. (2007)	1997 (657 companies)	210,495
Hariri et al. (2007)	1999 (678 companies)	201,470
Che Ahmad et al. (2006b)	2002 (819 companies)	194,960
Yatim et al. (2006)	2003 (736 companies)	191,975
Abdul Wahab et al. (2009)	1999 to 2003 (390 companies)	282,200
Johl et al. (2012)	2005 (559 companies)	240,956
Rusmin et al. (2009)	2007 (105 companies)	185,480**
Yaacob and Che-Ahmad (2012)	2004 to 2008 (2210 companies)	212,532

* This amount is derived from sum of average audit fees for big and non-big firms, divided by two to get the average fees.
** The actual amount is USD54,553 (USD1= RM3.40).

Table II shows that the amount of audit fees paid by the companies is more than RM140,000 per financial year. There is an increment of audit fees in studies conducted between 1993 to 1996, 1997 and 1998. The increments between the 1997 and 1999 period are probably because of the Asian financial crisis, which put companies in a high risk position. Abdul Wahab et al.(2009) is the only study that shows audit fees of almost RM300,000 paid by the companies. With the exception of fees paid between 1993 and 1995 (Che Ahmad, Houghton & Mohamad Yusof, 2006a), all studies conducted after that period reveal increment in audit fees. The increment could be due to clients' business growth and complexity.

Data and methods

This study examines all Malaysian listed companies for the years of 2008, 2009 and 2010. By covering a longer period, the trend of the audit market over time can be explained. The study began with data for 2008 companies because at the end of 2008, there was a global financial crisis which started in the US and the crisis also has affected Malaysian economies (Nambiar, 2009). Further, in 2010, the regulatory body to monitor audit firms (i.e. the Audit Oversight Board) was established. After the screening process, the total

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number of companies included in this study, as shown in Table III, from 1998 to 2010 is 2,854.

Table III

Sample selection

Screening process/Year	**2008**	**2009**	**2010**	**Total**
Initial number of listing companies (Source: closing price for all stocks as at 31 December 2008/09/10).	990	972	971	2933
Less:				
Annual reports are not publicly available	(28)	(9)	(23)	(60)
Companies incorporated outside Malaysia	(4)	(7)	(8)	(19)
Final dataset	**958**	**956**	**940**	**2854**

To identify the structure of the Malaysian audit market, several approaches as suggested by Abidin, Beattie and Goodacre (2010) were employed. Theexamination of audit market structure wasbased on the following measures: (i) rate of audit fees per unit of size (ii) audit market concentration,[1] and (iii) individual audit firm's market share.

Results and discussion

Descriptive statistics

Table IV presents number of auditors, total audit fee, including the mean of audit fee.

Table IV

Number of auditor, total audit fee, including the mean.

	2008	**2009**	**2010**	**2008 – 2010 change (%)**
Number of auditors	**94**	**96**	**85**	**-9.57**
Audit fees (RM'000)	**224,624**	**241,753**	**257,281**	
Mean (RM'000)	234	253	274	17.09
Minimum (RM'000)	4	3	3	
Maximum (RM'000)	15,200	18,100	19,000	

It is interesting to note that even though the total number of Malaysian audit firms is slightly growing,[2] the same pattern is not reflected in the number of firms that provides audit service to listed companies. In fact, the number of audit firms from 2008 to 2010 has reduced by almost 10%.[3] The low percentage of audit firms serving in the PLCs' market might indicates that the entry barrier into the audit market of listed companies is high.

[1]The market share was calculated by dividing the number of companies (or audit fees, total assets) audited by particular auditor by the total number of companies (or audit fees, total assets) in the sample. The ratio of the top 4, 6, 8, 10 firms was then added.

[2]The number of audit firms as at 30 June of 2008 was 1,348, 2009: 1,352 and 2010:1,356 (MIA Annual Report 2008, 2009, 2010).

[3] Since there is no major merger or acquisition activity of audit firms in 2010, the activity is unlikely to contribute to less number of audit firms. The only merger event is between JB Lau & Associates with Grant Thornton but it was on 1 January 2008. Further, the merger did not seriously impact the market since JB Lau & Associates only held over 15 PLCs (Source: http://www.gt.com.my/press_release_3jan2008.html).

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Particularly in Malaysia, with the implementation of the AOB, it would make audit firms' access into the audit market of listed companies are more limited.

Total audit fees per year is about a quarter billion, and the pattern of audit fees indicates an increase from year to year. There are several factors associated with the increment of audit fees from 2008 to 2010. Due to the establishment of the AOB, the choice of potential auditor to be selected has been lessened, and it would make the remaining firms in the market have more power (i.e. ability to charge higher fees).

Rate of audit fees per unit of size

To explain whether the increment of fees is reflected by size of client (total assets), further analysis was performed.

Table V
Mean audit fee per RM'000 total assets

	Small									**Large**
	1	2	3	4	5	6	7	8	9	10
2008	2.64	0.93	0.74	0.61	0.69	0.44	0.32	0.28	0.35	0.12
2009	3.57	1.02	0.81	0.65	0.50	0.42	0.33	0.28	0.24	0.13
2010	13.61	1.33	0.83	0.68	0.49	0.45	0.33	0.28	0.24	0.12
2010 vs. 2008 t-stat	0.96	1.53	1.26	1.33	-1.42	0.12	0.66	0.07	-1.12	0.96

*** significant at 0.01, ** significant at 0.05 and * significant at 0.10 (2 tailed), Paired Samples t- Test.

Table Vclearly indicates that due to fixed costs and the standardised audit procedures employed, the mean audit fee rate generally decreased as company size increased. This means the bigger the size of companies, the lower the audit fee incurred. Specifically, high audit fee rate is incurred for small size of companies and not for big companies. It is in line with Abidin et al.'s (2010) study in the UK that economies of scale is beneficial for large companies. A study in an Asian country, i.e. Japan, also shows that when auditees have higher bargaining power, the audit firms lessen the fees charged to their clients (Fukukawa, 2011). To a certain extent, the argument that auditors would like to use their market power to enjoy higher revenue is mainly applicable for small companies and not for big size companies.

Auditor concentration

Table VI reports the level of auditor concentration from 2008 to 2010. For comparison purposes, market share for Big Four firms (CRBIG4) is also presented.

Table VI
Auditor concentration ratio (CR)

Auditor concentration	**Number of audit (%)**			**Audit fees (%)**			**Total Assets (%)**		
	2008	2009	2010	2008	2009	2010	2008	2009	2010
CR4	57.9	57.5	58.4	77.3	76.6	76.7	92.8	91.7	92.1
CR6	70.0	68.5	68.7	85.4	84.9	85.4	96.4	94.7	95.0
CR8	77.1	76.2	76.8	88.9	88.4	88.9	98.2	96.6	96.9
CR10	81.1	79.8	80.5	91.5	91.3	91.5	99.1	97.5	97.7
CR12	83.3	82.4	82.8	93.1	92.9	93.0	99.4	97.9	98.1
CRBIG4	57.3	54.4	53.2	77.3	76.6	76.2	90.7	91.1	91.4

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Note:
1. CR4 = 4-firm concentration ratio, CR6 = 6-firm concentration ratio, CR8 = 8-firm concentration ratio, CR10 = 10-firm concentration ratio, CR12 = 12-firm concentration ratio, CRBIG4 = Big Four-firm concentration ratio.

The result in Table VI shows that the level of concentration exceeds 50%. High concentration mostly associated with concentration rate that based on audit fees and total assets, rather than number of audits. In concentration rate that based on number of audits, CR4 is higher than CRBIG4. Even though CRBIG4 market shared based on number of audits was on a negative trend, their audit fee reduction is relatively small. A small reduction should not worry them since the big audit firms can recoup audit fixed cost through high audit fees as compared to small audit firms (Defond & Lennox, 2011). In addition, many big companies most probably remain with them due to their audit expertise. The reduction in number of clients explains that large audit firms want to avoid new audit investment problem andprobably the investments not beneficial to the firm.

From the economic perspective, in general, the Malaysian audit market has exceeded the tight oligopoly cut-off. A tight oligopoly is present if the market share of the highest four firms is more than 60% (Shepherd, 1997).[4] In high market concentration, there is possibility of pricing collusion, ability of audit firm to charge high audit fee and ease of audit market allocation among the top firms (Dopuch & Simunic, 1980; Abidin et al., 2010). Nevertheless, whether the concentration is beneficial or harmful to market players and affects audit quality is uncertain (Francis, Michas & Seavey, 2013). According to Beattie et al. (2003) and Abidin et al. (2010), the presence of high market share does not necessarily lead to anti-competitive behaviour or indicate limited market competition.

Individual firm market share at market level

Table VII shows the percentage of market share based on number of audit and fees for individual firm.

Table VII

Percentage of market share (rank) based on number of audit and fees for individual firm

Audit Firm	Number of audits			Fees		
	2008 %	2009 %	2010 %	2008 %	2009 %	2010 %
Deloitte	6.9 (5)	6 (5)	5.2 (5)	5.4 (4)	4.6 (5)	4 (6)
Ernst & Young	27.7 (1)	26.4 (1)	26.3 (1)	30.5 (1)	30.2 (1)	28.8 (2)
KPMG	14.9 (2)	14.1 (2)	14.2 (2)	12.6 (3)	12.6 (3)	12.7 (3)
PwC	7.8 (3)	7.9 (4)	7.5 (4)	28.8 (2)	29.2 (2)	30.7 (1)
Total Big Four (a)	**57.3**	**54.4**	**53.2**	**77.3**	**76.6**	**76.2**
BDO	5.2 (6)	4.8 (7)	4.5 (7)	5.1 (5)	4.6 (4)	4.3 (5)
Grant Thornton	4.7 (7)	5 (6)	5.1 (6)	1.31 (10)	1.4 (10)	1.8 (8)
Crowe Horwath	7.5 (4)	9.1 (3)	10.4 (3)	3 (6)	3.7 (6)	4.5 (4)

[4]The modern industrial organisation study categorises markets into six types. Three market types are characterised by high market power and generally ineffective competition: monopoly (one firm has 100%); dominant firm (one firm has 40% to 99%); and tight oligopoly (four firms have over 60%). The other three market types exhibit effective competition: loose oligopoly (four firms have less than 40%), monopolistic competition (many competitors each with a slight degree of market power) and pure competition (many competitors, none of whom has market power) (Beattie, Goodacre & Fearnley, 2003).

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Baker Tilly Monteiro Heng	2.4 (8)	2.9 (8)	3.6 (8)	1.33 (9)	1.5 (9)	1.5 (9)
Mazars*	1.7 (10)	1.8 (9)	1.4(11)	1.7 (8)	1.6 (8)	1 (10)
Moore Stephens	2.3 (9)	1.8 (9)	1.7 (10)	1.2(11)	1 (11)	0.9 (11)
HLB Ler Lum	0.7(12)	0.8(10)	0.9(12)	1.8 (7)	1.9 (7)	2 (7)
UHY	1.5(11)	1.8 (9)	2 (9)	0.4(12)	0.6(12)	0.6 (12)
Total (8 firms)	**26**	**28**	**29.6**	**15.8**	**16.3**	**16.6**
Other firms	**16.7**	**17.6**	**17.2**	**6.9**	**7.1**	**7.2**
Total non-Big 4 (b)	**42.7**	**45.6**	**46.8**	**22.7**	**23.4**	**23.8**
Total (a) + (b)	**100**	**100**	**100**	**100**	**100**	**100**
Total audit fees (RM'000)				224,624	241,753	257,281
Number of companies	958	956	940			

*Prior to 1 September 2008, the firm was known as Moores Rowland. The name change reflects the merger of Moores Rowland with global structure of Mazars.

Based on the TableVII**,** two of the firms from Big Four group consistently have the highest number of audits, namely Ernst & Young and KPMG. PwC is the third highest in 2008, and the firm's position dropped to fourth place in 2009 and 2010. The third place firm in 2009 and 2010 was Crowe Horwath. Deloitte's market share is the fifth largest and their shares dropped almost 2% from 2008 to 2010. For second tier firms; BDO and Grant Thornton, both of the firms held approximately similar share, of around 5%.

Market share based on audit fees offers different rankings. While Ernst & Young had the highest number of audits in 2008 and 2009, the firm was unable to maintain its top rank in 2010. PwC strengthened its position, from second place in 2009 (29.2%) to first place in 2010 (30.6%). The gap between these two firms, however, is small, which indicates both firms are competing with each other. Ranking based on audit fees is not good indicator for KPMG, since the firm's position is lower (in the third place) than rank based on number of audits (in second place). For Deloitte, their share fell from fourth in 2008 to sixth place in 2010. Crowe Horwath made an impressive performance as the firm was the fourth largest firm in 2010, improving from sixth largest in 2008.

The result from Table VII implies that different business strategy is adopted among audit firms. Competition arises among Big Four firms, suggesting each of them utilises different pricing strategy and client acceptance policies. A similar pattern is also observed among non-Big Four firms; for instance, audit firm HLB Ler Lum. The firm has between seven to eight clients and is ranked between tenth to twelth place. HLB Ler Lum, however, is the seventh largest firm based on audit fee and it is bigger than Baker Tilly, Mazars, Moore Stephens and UHY. It is suggested the audit firm is highly dependent on low number of companies to generate income. Such dependence could be a threat to auditor objectivity and violates audit quality.

Conclusion

This study examines overall Malaysian audit market structure. The finding show increment of audit fees and small reduction number of audit firms. With regards to the effect of companies' size on audit fee, the bigger the company is, the lower the audit fee clients have to pay (i.e. the benefit of economies of scale). The analysis also show that Malaysia market is highly concentrated and it is a tight oligopoly market.

It contradicts the general belief that the market is fully concentrated within the group of Big Four firms. In fact, a non-Big Four firms Crowe Horwarth is enlarging its market share. Competition among Big Four firms is mainly between PwC and Ernst & Young and it is

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suggested that PwC is focusing on big companies that result in betterment of audit revenue. The availability of non-Big Four firms as one of the main market players provides an early sign that the dominance of Big Four firms in the audit market of listed companies has begun to collapse, at least in Malaysia.

The current audit practice indicates that high quality audit firms avoid small and probably risky clients. The practice may affect audit quality where dependence on certain type of clients leads to firm's independence impairment. Also, disassociation between large audit firm and small and medium companies might increases companies difficulty to access capital market and delays its growth.

The findings of this study may draw some implications. To reduce the gap between Big Four and non-Big Four firms, and to minimise the burden of audit firms, merger or firm's affiliation activities among non-Big Four firms should be encouraged. Meanwhile, the AOB should consider the audit firm's portfolio and their client acceptance decision aspects in monitoring quality of the firms. Finally, usage of Big Four firms and non-Big Four to represent the level of quality should be used with caution, at least in the Malaysian context. Instead, the usage of specialist and non-specialist firm should be promoted, since it portrays the reality of audit quality performed.

This study, however, suffer some limitations. Since the study tested listed companies for three years, future study could extend a longer period (post AOB) and investigate on non-PLCs market. This study also not able to determine whether audit programme plans and risk management strategies are really adjusted as a response to changes in the business environment. With the advancement of technology, however, the adjustment of audit programme is not as difficult as before. Future studies might examine how computerised decision aid can help to adjust audit planning and pricing.

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