

**THE EFFECTS OF COMPANY'S CHARACTERISTICS, AUDIT QUALITY,
AND GOOD CORPORATE GOVERNANCE MECHANISM ON GOING-
CONCERN MODIFIED AUDIT OPINION ON MANUFACTURING
COMPANIES LISTED ON INDONESIA STOCK
EXCHANGE (BEI)**



Script by:
STEPHANI VALENTINE PUTRI
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Accounting

*Proposed in Partial Fulfillment of the Requirements
for the degree of
Economics Bachelor*

MINISTRY OF EDUCATION AND CULTURE
SRIWIJAYA UNIVERSITY
ECONOMIC FACULTY

2012

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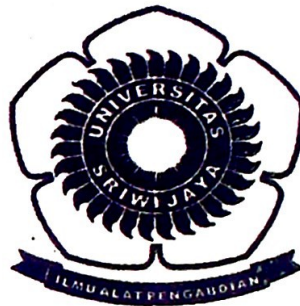
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2012

**MINISTRY OF EDUCATION AND CULTURE
SRIWIJAYA UNIVERSITY
ECONOMIC FACULTY
INDERALAYA**

COMPREHENSIVE EXAM APPROVAL PAGE

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EXCHANGE (BEI)**

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Date of Approval

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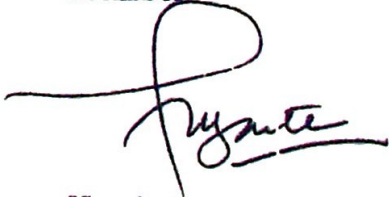
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**MINISTRY OF EDUCATION AND CULTURE
SRIWIJAYA UNIVERSITY
ECONOMIC FACULTY
INDERALAYA**

SCRIPT APPROVAL PAGE

**THE EFFECTS OF COMPANY'S CHARACTERISTICS, AUDIT QUALITY,
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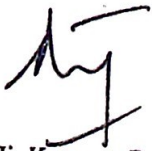
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Comprehensive Exam Committee
Inderalaya, 20 October 2012

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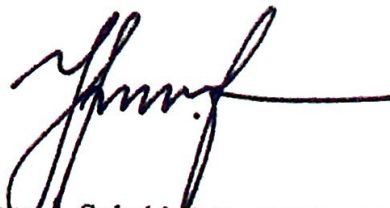


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The Effects of Company's Characteristics, Audit Quality, And Good Corporate Governance Mechanism on Going-Concern Modified Audit Opinion on Manufacturing Companies Listed on Indonesia Stock Exchange

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Member : Hasni Yusrianti, S.E., M.AAC., Ak.
Date of Comprehensive Exam : 16 October 2012

is truly the result of my work under guidance of supervisors. There is no other's people work in this script that I copy the whole or part without mentioning the original source.

Thus, this statement I made in good faith and if it turns out my statement is not true in the future, then I'm willing to accept sanctions in accordance with the regulations, including the cancellation of my degree.

Inderalaya, 19 October 2012

Who gave the statement,



Stephani Valentine Putri
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PREFACE

Assalamu'alaikum Warahmatullahi Wabarakatuh.

Alhamdulillahirobbil'alamin. The writer would like to express her praise and gratitude to Allah SWT, God who has been giving His blessing and mercy to the writer to complete the script entitled "The Effects of Company's Characteristics, Audit Quality, and Good Corporate Governance Mechanism on Going-Concern Opinion on Manufacturing Companies Listed on Indonesia Stock Exchange (BEI)". This script is submitted to fulfill one of the requirements to. This script would not have been possible without the guidance and the help of many individuals who in one way or another contributed and extended their valuable assistance in the preparation and completion of this study; they are:

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20. My classmates in Accounting Department. Thank you for the great teamwork.
21. Last but not least, the writer would like to thank everybody who was important to the successful realization of script, as well as expressing writer's apology that she could not mention personally one by one.

Finally, the writer realizes that there are unintended errors in composing this script. The writer really allows all readers to give their suggestions to improve its content in order to be made as one of the better examples for the next script.

Wassalamu'alaikum Warahmatullahi Wabarakatuh.

Inderalaya, 2 October 2012
Writer



Stephani Valentine Putri

ABSTRACT

THE EFFECTS OF COMPANY'S CHARACTERISTICS, AUDIT QUALITY, AND GOOD CORPORATE GOVERNANCE MECHANISM ON GOING- CONCERN MODIFIED AUDIT OPINION ON MANUFACTURING COMPANIES LISTED ON INDONESIA STOCK EXCHANGE (BEI)

By:

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This paper describes the influence of company's financial condition, audit quality, company's growth, institutional ownership, managerial ownership, independent commissioner and audit committee toward going-concern modified audit opinion. Audit opinion issued by the auditor is expected by financial users because the auditors' opinion is used as basis for making decision, especially for investment. The variables which are used are varying and the research results are not conclusive. This paper uses 105 sample manufacturing companies which is listed on Indonesia Stock Exchange (BEI) from 2006-2010. The hypotheses of the paper are investigated using logistic regression. The result indicates that company's financial condition, institutional ownership, and audit committee influence the acceptance of a going-concern modified opinion and audit quality, company's growth, managerial ownership and independent commissioner do not influence the acceptance of a going-concern modified opinion. All the independent variables influence the acceptance of a going-concern modified opinion

Keyword: *Going-Concern Opinion, Company's Characteristics, Audit Quality, GCG Mechanism*

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CHAPTER I

INTRODUCTION

1.1. Research Background

The general objective of the audit of financial statements is to express an opinion on the fairness of financial statements, in all material respects, in accordance with Generally Accepted Accounting Principles (GAAP). It is completely stated on Statement of Audit Standard 1 (SAS 1/ AU 110):

“The objective of the ordinary audit of financial statements by the independent auditors is the expression of an opinion on the fairness with which they present fairly, in all material respects, financial position, result of operations, and its cash flows in conformity with generally accepted accounting principle.”(Arens, *et al.*, 2003:136).

That section of the SAS appropriately emphasizes issuing an opinion on financial statements. In determining whether financial statements are fairly stated in accordance with GAAP, the auditors perform appropriate test to determine whether the financial statements contain material errors or other misstatement. One of the ways to reach the audit object is by accumulating audit evidence (Arens, *et al.*, 2003)

The only reason auditors accumulate evidence is to enable them to reach conclusions about whether financial statement is fairly stated in all material respects and to issue an appropriate audit report (Arens, *et al.*, 2003). When, on the basis of adequate evidence, the auditor concludes that the financial statements are unlikely to mislead a prudent user, the auditor gives an audit opinion on their fair presentation and associates his or her name with the statements. If facts

subsequent to their issuance indicate that the statements were actually not fairly presented, the auditor is likely to have to demonstrate to the courts or regulatory agencies that he or she conducted the audit in a proper manner and drew reasonable conclusions. Although not an issuer or a guarantor of the fairness of the presentation in the statements, the auditor has considerable responsibility for notifying users whether the statements are properly stated. If the auditor believes that the statements are not fairly presented or is unable to reach a conclusion because of insufficient evidence or prevailing conditions, the auditor has the responsibility for notifying the users through the auditor's report.

The only public communication mechanism which is available to external auditors is their audit report (Blay *et al.* 2011). Reports are essential to audit and assurance engagements because they communicate the auditor's findings. Users of financial statements rely on the auditor's report to provide assurance on the company's financial statements (Arens, *et al.*, 2003: 46). The communication conveyed in the auditor's report is part of the information made publicly available when the company releases its annual report. As part of this information, the auditor expresses a professional opinion regarding the accuracy and completeness of the client's financial information and disclosures. In addition, if deemed warranted, professional standards in SAS No. 59 (AICPA, 1998; Blay *et al.*, 2011) require the auditor to add explanatory paragraph to his or her report identifying cases where, in the auditor's judgment, there exist "substantial doubt" about the continued viability of the client over the next reporting year.

While professional standards are clear that the responsibility of the external auditor does not extend to predicting the future viability of the audit client, they do require that auditors actively assess the continued viability of every audit client in every engagement. This additional communication regarding the auditor's judgment with respect to the future viability of the client goes beyond providing a professional attestation on the accuracy and completeness of the firm's reporting and disclosure, and provides additional information to the financial markets concerning the auditor's assessment as to the risk that the company may not continue in business in the foreseeable future. Thus, a going-concern modified audit opinion is the only way an external auditor can indicate his or her perceived risk regarding the continued viability of the client (Blay *et al.*, 2011).

Generally, the existence of one or more of the following factors causes uncertainty about the ability of a company as a going concern (Arens, *et al.*, 2003: 49):

- a) Significant recurring operating losses or working capital deficiencies.
- b) Inability of the company to pay its obligations as they come due.
- c) Loss of major customer, the occurrence of uninsured catastrophes such as an earthquake or flood, or unusual labor difficulties.
- d) Legal proceedings, legislation, or similar matters that have occurred that might jeopardize the entity's ability to operate.

The fraud of data manipulation, which happened to WorldCom and Enron has given bad accounting profession to criticism that public confidence

declined to the quality of auditor. There are two main forms of accounting fraud which occurred to Worldcom: first, understatement of operating expenses through improper release of accruals and through improper capitalization of operating expenses and second, overstatement of revenues. As the result, not only 57,000 employees lost their jobs and lost most of their retirement savings, but also its director of accounting and accounting department manager were in prison and probation (Meyer, 2007).

Many cases of financial data manipulation that can not be detected and information about the viability which has not been disclosed by the auditor caused a loss of confidence in the auditor's own (Setiawan, 2011). As the independent party, auditors are expected to detect fraud and disclose the company's overall information.

Since the existence of economic crisis in Indonesia, the issue of survival of the company is getting into the public spotlight. The economy was bad and many companies went bankrupt because they can not continue their business. Evidence suggests that, there are 14 companies in 1997 and 15 companies in 1998 which has issued clean audit reports in the previous year, but they collapsed in the following year (Haron, dkk., 2009; Setiawan, 2011). So, if this problem continues, this will cause the loss of confidence in auditors, and this will also cause the loss to stakeholders. Therefore, the topic of going concern is still very attractive to be used as research material because it is still common and is associated with the interests of many parties (Setiawan, 2011).

The company's soundness level can be seen from the company's financial condition. The auditor tends not to issue a going-concern modified audit opinion to companies that have a good financial condition (Ramadhany, 2004; Susanto, 2009). Rudyawan and Badera (2009) stated that the better the company's financial condition, the less likely the auditor to give a going concern audit opinion. Bankruptcy may be an indication of a company experiencing financial distress, which is a situation where the company's operating cash flow is insufficient to meet its current liabilities and the company was forced to take some steps to improve (Ross *et al.*, 2002; Solikah, 2007). This means, the auditor gives going concern audit opinion only to companies experiencing financial distress.

Audit quality can be described by auditor's quality. Auditors who have a good quality audit likely will provide a going concern modified audit opinion to firms who are experiencing problems regarding the going concern (Santosa and Wedari, 2007; Setiawan, 2011). Based on the results of the study, big four CPA firms and non big four CPA firms will always be objective in giving the opinion. If companies are having doubts in continuing its operations, they will be given going-concern modified audit opinion (Komalasari, 2004; Susanto, 2009). As the contrary, auditor quality affects the acceptance of a going-concern modified audit opinion. Big four CPA firms tend to give an unqualified opinion than non big four CPA firms who are likely to give going-concern modified audit opinion (Rahayu, 2007; Susanto, 2009).

Income is the main objective auditees in operating their business. Auditee who has positive income growth ratio indicates that auditee can maintain its

economic position and going concern. This ratio measures how well a company to maintain its economic position, both in industry and in overall economic activity (Weston and Copeland, 1992; Setyarno *et al.*, 2006). This is consistent with the statement of Weston and Bringham (2003). Companies with high income growth tend to have a reasonable report, so the potential for going concern modified audit opinion will be smaller (Santosa and Wedari, 2007).

Some cases of accounting scandals dealing with financial data manipulations that interfere with the viability of a company, particularly relevant to corporate governance. Organization for Economic Cooperation and Development (OECD) stated that corporate governance is one key element in improving economic efficiency, which includes a series of relationships between the company's management, board of directors, shareholders, audit committees and other stakeholders. Implementing good corporate governance is expected to reduce the chance of the manager to take action so that the manipulation of reported performance reflects the actual economic situation of the company (Jensen, 1993; Ujiyantho and Pramuka, 2007; Setiawan, 2011). Komite Nasional Kebijakan Governance (KNKG, 2006; Setiawan, 2011) explained that the company should base the management of the company on the principles of Good Corporate Governance so that the company will run well. These principles are transparency, accountability, responsibility, independency, and fairness. Large companies tend to have applied the principles of good corporate governance based on corporate governance which have implications for the improvement of company performance. Thus, companies that have bigger portion of managerial

ownership which is part of good corporate governance mechanism are unlikely to get a going-concern modified audit opinion (Linoputri, 2010).

In Indonesia, the issue of auditor's report and its relationship with the company's survival problem has existed since 1995 (Setiawan, 2011). This issue was marked by the collapse of Bank Summa, although the bank has issued an audit report which is fairly presented in the previous year, it does not guarantee the survival of the entity (Setiawan, 2011).

Table 1.1. Companies with Going-concern Opinion

	Year		
	2008	2009	2010
Number of companies that accepted Going-concern Modified Audit Opinion	21	19	15
Number of companies that did not accept Going-concern Modified Audit Opinion	68	70	74

Source: Processed secondary data

Table 1.1 above shows the number of companies that accepted going-concern modified audit opinion and companies that did not accepted going-concern modified audit opinion. From 89 companies which have complete financial statements, we found that around 30% companies in Indonesia during 2008-2010 were given going concern audit opinion. It means that the auditors conclude that there is substantial doubt about their ability to continue as a going concern. Most of them are experiencing loss in their operational activities and experiencing deficiency of equity from period to another period.

Many problems come up when audit failures occur related to going concern audit opinion (Mayangsari, 2003; Noverio, 2011). The first thing is self-fulfilling prophecy which results auditor's reluctant to disclose going concern status on audit report. This is related to auditor's anxiousness about the effect of going concern opinion which will accelerate a company to go to its failure. But on the other hand, the disclosed going concern opinion will immediately accelerate the rescuing of problem companies. The second problem which causes an audit failure is no existence of structured procedure in determining going concern status (Joanna, 1994; Noverio, 2011). Thus, it is nearly stated that there is no such a clear and provided guide or research result which can be used as the reference to determine going concern audit opinion. Because of that reason, giving a going concern status is not an easy job. Mutchler *et al.* in 1997 found evidence which stated that going concern audit opinion decision before bankruptcy happened significantly correlated to: (i) bankruptcy probability and audit report lag variable; and (ii) there is contrary information, as default. If default happens or negotiation process is taking place at the moment, the auditor's tendency to issue going concern audit opinion will increase (Noverio, 2011).

Studies on the factors affecting going-concern opinion have been carried out both overseas and in Indonesia. This research is replicated from Teguh Heri Setiawan's (2011). The differences of these studies are the year of observation, which is 5 years from 2006-2010; company's growth factor which is added to this research, and debt default and prior year going-concern opinion factor which are not used in this research.

Seeing the enormous influence of a going-concern modified audit opinion on the financial statements of the client that reduces the public confidence invested in the company's management in managing the business and the auditor in assessing the viability of his clients, the author is interested to investigate the going-concern modified audit opinion by taking title "Factors Influencing the Acceptance of Going-concern Modified Audit Opinions on Manufacturing Companies listed on Indonesian Stock Exchange (BEI)".

1.2. Problems Statement

Based on background above, the problems that come up with this research are as follows:

- a) Does company's financial condition influence the acceptance of a going-concern modified audit opinion?
- b) Does audit quality influence the acceptance of a going-concern modified audit opinion?
- c) Does company's growth influence the acceptance of a going-concern modified audit opinion?
- d) Does institutional ownership influence the acceptance of a going-concern modified audit opinion?
- e) Does managerial ownership influence the acceptance of a going-concern modified audit opinion?
- f) Does independent commissioner influence the acceptance of a going-concern modified audit opinion?

- g) Does audit committee influence the acceptance of a going-concern modified audit opinion?
- h) Do all the independent variables simultaneously influence the acceptance of a going-concern modified audit opinion?

1.3. Research Objectives

The objectives of this research are as follows:

- a) To know the relationship between company's financial condition and the acceptance of a going-concern modified audit opinion.
- b) To know the relationship between audit quality and the acceptance of a going-concern modified audit opinion.
- c) To know the relationship between company's growth and the acceptance of a going-concern modified audit opinion.
- d) To know the relationship between institutional ownership and the acceptance of a going-concern modified audit opinion.
- e) To know the relationship between managerial ownership and the acceptance of a going-concern modified audit opinion.
- f) To know the relationship between independent commissioner and the acceptance of a going-concern modified audit opinion.
- g) To know the relationship between audit committee and the acceptance of a going-concern modified audit opinion.
- h) To know the relationship between all the independent variables and the acceptance of a going-concern modified audit opinion.

1.4. Research Benefits

The result of this research is expected to give the benefits as follows:

a) **Academic Benefit**

To give the addition of empirical evidence to accounting sector, especially about the influence of company's financial condition, audit quality, sales growth and Good Corporate Governance (GCG) mechanism to acceptance of a going concern audit opinion.

b) **Practical Benefit**

1. **Investors**

The study is expected to be useful to inform and for consideration of going concern (continuity of business of a company) so that investors and potential investors can make good decisions in investing.

2. **Auditors**

This research can be useful as a guide and reference of material consideration for the auditors in performing audit processes, especially in terms in providing an audit opinion to client who comes to the provision of going concern audit opinion.

3. **Creditors**

Bankruptcy information can be useful to make a decision which will be given a loan and then be useful to monitor the policies of existing loans.

4. **Government**

This research can be useful as a material consideration in making economic policies.

1.5. Systematic Report

In order to give a clear illustration and direction of the discussion, author divides the discussion of this script into 5 (five) chapters, where each chapter is divided into several subchapters with following systematic:

CHAPTER I : INTRODUCTION

This chapter tells about the research background, problem statements, research objectives, and systematic of report.

CHAPTER II : REVIEW OF LITERATURE

This chapter explains the theories, which are the basic of this script. The author only writes theories concerning the process of composing this script.

CHAPTER III : RESEARCH METHODOLOGY

This chapter discusses research object, methods of data collection, types and sources of data used and data analysis methods.

CHAPTER IV : ANALYSIS AND DISCUSSION

This is the main point of this research. This chapter will tell about the result of the research and will explain about hypothesis appropriate to the result.

CHAPTER V : CONCLUSIONS AND SUGGESTIONS

This chapter is the closing chapter of this script, which outlines to the conclusions of research that has been done by author and several suggestions for the object as an alternative to reduce problems that commonly occur.

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