

Factors that Influence the Auditors in Issuing Qualified Opinion

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ABSTRACT

This study examines the effect of Earnings Management, Audit Quality, Audit Tenure, Firm Size, Leverage, Liquidity, Inventories, Losses, and Profitability on Qualified Opinion among manufacturing companies in Indonesia. This research used 102 manufactured companies listed in Indonesia Stock Exchange (IDX) from 2013 to 2018 using the purposive-sampling method. This research used binary logistic regression to analyse the data. The results show that there is no influence of Earnings Management, Audit Quality, Audit Tenure, Firm Size, Leverage, Liquidity, Inventories, Losses, and Profitability on Qualified Opinion.

Keywords: *earnings management, audit quality, audit tenure, firm size, leverage, liquidity, inventories, losses, profitability, qualified opinion*

1. INTRODUCTION

Various efforts are made by companies to follow the progress of the economy every year, starting from making innovations continuously, improving the quality of goods produced, as well as improving company's management. One of the policies undertaken is to increase the trust of users of financial statements.

Audit reports become a tool for public accountants to express their opinions. According to [1], audit opinion is the results from auditors' assessment of the company's performance assessed through the company's financial statement. The auditor gives an audit opinion through several stages so that the auditor can provide conclusions and opinions from the audited financial statements.

According to [1], to generate a good audit report, there are many factors that influence it, from the company's financial ratios, performance level, competence, objectivity, and skepticism held by auditors [2]. In this study, the company's financial ratios are discussed using Earnings Management, Company Size, *Leverage*, Liquidity, Inventory, Losses, and Profitability. Meanwhile, things related to auditors are discussed using Audit Quality and Audit Tenure.

A case related to the auditors' error in conveying their opinion is PT Indosat Tbk (2011), which was audited by Public Accounting Firm (or KAP) Ernst & Young. KAP Ernst & Young provided an audit opinion based on insufficient evidence [3]. Apart from the Indosat case, there is a similar one. The SNP Finance case whereas Public Auditor Marlinna, Public Auditor Merliyana Syamsul, and Public Accounting Firm (KAP) Satrio, Bing, Eny, and Partners, provided an audit opinion that did not reflect the actual financial condition [4].

This research refers to [1] to determine the leading causes of issuing Qualified Opinion by examining Earnings

Management, Audit Quality, Audit Tenure, Company Size, Leverage, Liquidity, Inventory, and Losses. Still, there is an additional independent variable, namely Profitability. Therefore, the title of this research is "Factors that Influence the Auditors in Issuing Qualified Opinion".

This study aimed to examine the effects of Earning Management, Audit Quality, Audit Tenure, Company Size, Leverage, Liquidity, Inventory, Losses, and Profitability on Qualified Opinion. This research is expected to provide the benefits for company's management, investors, and authors of further research.

The systematics of this study is divided into five parts. The first is an introduction that contains background, research problems, research objectives, and research benefits. The second is the theoretical framework and hypotheses development from the variables used. The third, is the research method that explains how to measure the variables used. The analysis and discussion that explains the research results are the fourth. The fifth is the discussion regarding this research result. And the last, is closing part that contains the conclusions, recommendations, and limitations.

1.1. Public Interest Theory

According to [5], Public Interest Theory stated that the main reason for government intervention in various matters of business operations is the public interest. It is based on the assumption that market economy is the subject of imperfect markets or transaction failures. If being left unchecked, it will result in inefficient and unfair results. Meanwhile, according to [1], regulations are agreed by the authority to protect the stakeholder, such as customer. In this case, the regulations are about audit standards as the main guidelines for auditors.

1.2. *Qualified Opinion*

According to [1], audit opinion results from the auditor's assessment of the company's performance as assessed through the company's financial statements. In SA 508 [6], it is stated that there are several types of audit opinions that are usually given by auditors when auditing the financial statements, including Unqualified Opinion, Qualified Opinion, Modified Unqualified Opinion, Adverse Opinion, and Disclaimer Opinion. Qualified Opinion occurs when some information contains material misstatements, and the financial statements of a company being examined are presented fairly [7]. These are deviations material but not pervasive to financial statements.

1.3. *Earnings Management and Qualified Opinion*

Earnings Management is done intentionally within the limit of a desired level of profit. Earnings management can be defined as a management publication with full intervention to external parties' coverage of financial process to obtain personal benefits [8]. There are four patterns in Earnings Management, namely taking a bath, income minimization, income maximization, and income smoothing [9]. If there is an increase in Earnings Management, it will reduce the company's probability of getting a Qualified Opinion [10].
H₁: Earnings Management has an effect on Qualified Opinion.

1.4. *Audit Quality and Qualified Opinion*

[11] argued that audit quality is related to the size of the audit firm, with the proxy for audit firm size being the number of clients. In Indonesia, there are global Public Accounting Firms commonly known as the Big Four: Price Waterhouse, KPMG (Klynveld Peat Marwick Goerdeler), Ernst and Young, and Deloitte Touche Thomatsu. If there is an increase in Audit Quality, it will reduce the company's probability of getting a Qualified Opinion [12].
H₂: Audit Quality has an effect on Qualified Opinion.

1.5. *Audit Tenure and Qualified Opinion*

Audit Tenure is the length of time of work or relationship between the Public Accounting Firm and the client. The length of the cooperative relationship between the auditor and the client can make the auditor more aware of the company's condition so that it can be detected more easily [13]. However, a long working relationship can cause outsiders to question the independence of the auditors.
H₃: Audit Tenure has an effect on Qualified Opinion.

1.6. *Company Size and Qualified Opinion*

According to [14], company size is a value that shows the size of the company. Measurements are made by using the

total assets owned by the company. Large companies will usually get a Qualified Opinion [15].

H₄: Company Size has an effect on Qualified Opinion.

1.7. *Leverage and Qualified Opinion*

Leverage is the use of assets and sources of fund originating from loans to increase the potential profit of shareholders [16]. Leverage is a ratio that describes the amount of debt a company uses to finance its business activities compared to using its own capital [17]. The greater leverage ratio indicates that the company has a borrowing source greater than its own internal capital.

H₅: Leverage has an effect on Qualified Opinion.

1.8. *Liquidity and Qualified Opinion*

According to [17], liquidity is a financial ratio measuring a company's ability to meet its due obligations, both the obligations to external parties and those within the company. Liquidity is used to measure how liquid a company is. Liquidity is also beneficial for the company, measuring its ability to pay its obligations to the third parties, whereas the ability to pay provides guarantees to outsiders to lend capital, invest, or provide supplies to the company.

H₆: Liquidity has an effect on Qualified Opinion.

1.9. *Inventory and Qualified Opinion*

Inventories are goods or assets owned by companies traded in economic transactions as part of business operations [8]. There are two inventory recording systems, namely the Periodic Inventory System and the Perpetual Inventory System. According to [8], the periodic system and perpetual system have three ways of valuing inventory: First-in-First out, Last-in-First-out, and Average Method. High inventory shows that the company has less efficiency in running operational activities [1].

H₇: Inventory has an effect on Qualified Opinion.

1.10. *Losses and Qualified Opinion*

According to [18], a loss is a decrease in net assets that causes no revenue to be earned and arises from temporary transactions. Losses are decreases in the company's net assets that arise due to unexpected events [8]. Two things can cause losses. First, the amount of expenses is higher than the revenue, and the second, due to misstatements, the company can experience losses in the financial statements [1].

H₈: Losses has an effect on Qualified Opinion.

1.11. *Profitability and Qualified Opinion*

Profitability is the measure to determine the company's ability to acquire the profit from revenue [17]. This ratio is used by the company to measure the ability of company

management to gain overall profits. The higher the ratio is, the better the asset productivity is in obtaining net profit.
H₉: Profitability has an effect on Qualified Opinion.

2. RESEARCH METHODOLOGY

2.1. Sampling and Data Collection Method

Table 1 Procedure of Selecting the Sample

Criteria Description	Total Firms	Total Data
Manufacturing companies:		
That are consistently listed as manufacturing companies in Indonesia Stock Exchange from the year of 2012 to 2018	134	804
That do not use IDR as their primary currency in their financial statements from the year of 2012 to 2018	(28)	(168)
That do not consistently present annual report and financial statement as of December 31st in IDX from the year of 2014 to 2018	(2)	(12)
That do not have the complete required data during 2011 - 2015	(2)	(12)
Number of sample firms used	102	612

Source: Research Criterion (2020)

2.2. Operational Definition of Variables and Measurements

2.2.1. Qualified Opinion

A qualified opinion occurs when some information contains material misstatement and the financial statements of a company being examined are presented fairly [7]. Based on previous research, Qualified Opinion is measured using a dummy variable, whereas score 0 is the Unqualified Opinion, and score 1 is another Unqualified Opinion.

2.2.2. Earnings Management

Earnings management can be defined as the management disclosure with full intervention in the purpose of financial reporting process to external parties, to obtain benefits [8]. Based on previous research, Earnings Management is measured by the following equation:

a) *Non-Discretionary Accrual*:

$$NDA_{it} = \alpha_1 \left(\frac{1}{A_{i(t-1)}} \right) + \alpha_2 \left(\frac{\Delta REV_{it} - \Delta REC_{it}}{A_{i(t-1)}} \right) + \left(\frac{PPE_{it}}{A_{i(t-1)}} \right)$$

The object in this research is the auditors' opinion in the Annual Reports of public companies listed in IDX from the year 2013 to 2018. The sampling method used is purposive sampling. The criteria set by researchers in this study are described as follows:

b) *Discretionary Accrual*

$$DA_{it} = \frac{TA_{it}}{A_{i(t-1)}} - NDA_{it}$$

2.2.3. Audit Quality

According to [1], Audit Quality is a variable that affects the audit opinion because of its ability to detect and report false financial reports or the manipulation of materials in the financial reports. Based on [1], Audit Quality is measured by using dummy variables, whereas the score 0 is Public Accounting Firm besides the Big Four, and score 1 is the Big Four Public Accounting Firm.

2.2.4. Audit Tenure

Audit Tenure is the length of time of work or relationship between the Public Accounting Firm and the client. The length of the cooperative relationship between the auditor and the client can make the auditor more aware of the company's condition so that it can be detected more easily [13]. Based on previous research, the calculations are as follows:

TENURE = Number of years in which the same registered Public Accounting Firm has audited the company.

2.2.5. Company Size

According to [1], Company Size is a scale that determines the size of the company by using the company's total assets, log size, or stock market value. This company size determination is based on the company's total assets. Based on previous research, company size is measured as follow: $SIZE = \text{Log (average total assets at the end of the year)}$

2.2.6. Leverage

Leverage is the use of debt financing to increase the income [8]. It is a ratio that describes the level of debt compared to the company's assets. Based on [1], the leverage scale is measured as follow:

$$LEVR = \frac{\text{Total Liabilities}}{\text{Total Equity}}$$

2.2.7. Liquidity

Liquidity is a financial ratio measuring the company's ability to meet its due obligations, both the obligations to external parties and those within the company [17]. Based on previous research, the calculation is as follow:

$$LIKD = \frac{\text{Total Cash Position}}{\text{Total Current Liabilities}}$$

2.2.8. Inventory

Inventories are goods or assets owned by companies traded in economic transactions as part of business operations [8]. According to [1], High inventories indicates that the company has less efficiency in running its operational activities. Based on previous research, the calculation is as follow:

$$INV = \frac{\text{Total Inventory}}{\text{Total Assets}}$$

2.2.9. Losses

Losses are a decrease in the net assets of a company arising from unforeseen circumstances or events [8]. Based on [1],

losses are measured by dummy variables, whereas score 0 is the other and score 1 is the company that experiences losses.

2.2.10. Profitability

The profitability ratio used in this research is return on assets. Return on Asset according to [17] is the return on the amount of assets that the company benefits. Based on previous research, the following is the calculation method:

$$PROF = \frac{\text{Net Profit (Loss)}}{\text{Total Assets}}$$

2.3. Data Analysis Method

The logistics regression analyst is used in this study. The regression model formed in this research is as follow:

$$\text{Opinion} = \alpha + \beta_1(\text{MLABA}) + \beta_2(\text{KAUD}) + \beta_3(\text{TENURE}) + \beta_4(\text{SIZE}) + \beta_5(\text{LEVR}) + \beta_6(\text{LIKD}) + \beta_7(\text{INV}) + \beta_8(\text{LOSSES}) + \beta_9(\text{PROF}) + \epsilon$$

- Description:
- Opinion : Audit Opinion
- α : Intercepts
- $\beta_{1,2,3,4,5,6,7,8,9}$: Variable Coefficients
- MLABA : Earnings Management
- KAUD : Audit Quality
- TENURE : Audit Tenure
- SIZE : Company Size
- LEVR : Leverage
- LIKD : Liquidity
- INV : Inventory
- LOSSES : Losses
- PROF : Profitability
- ϵ : Error Residual

3. RESEARCH RESULTS

These are the results of this research, namely descriptive statistics and hypothesis-test results, as shown in Table 2 and Table 3.

Table 2 Descriptive Statistics

Variables	N	Minimum	Maximum	Mean	Std Deviation
OPINI	612	0	1	0.011438	0.106422
MLABA	612	-15.302558	1.192864	0.00000016	0.630154
KAUD	612	0	1	0.359477	0.480240
TENURE	612	1	6	2.723856	1.635496
SIZE	612	10.957532	14.505392	12.245590	0.679011
LEVR	612	-225.044848	162.192046	1.085997	11.610647
LIKD	612	0.000710	10.045648	0.567607	1.138950
INV	612	0.002163	0.632469	0.205850	0.134323

LOSSES	612	0	1	0.240196	0.427552
PROF	612	-0.548466	0.920997	0.047223	0.115204

Source: Output Data by SPSS (2020)

Table 3 Variables in the Equation

	B	Sig.	Hypothesis	Conclusion
Constant	-11.212	0.378		
MLABA	0.217	0.857	H ₁	Rejected
KAUD	-0.338	0.821	H ₂	Rejected
TENURE	-0.466	0.303	H ₃	Rejected
SIZE	0.844	0.432	H ₄	Rejected
LEVR	-0.002	0.924	H ₅	Rejected
LIKD	-15.962	0.184	H ₆	Rejected
INV	-8.340	0.095	H ₇	Rejected
LOSSES	-0.384	0.726	H ₈	Rejected
PROF	-7.166	0.056	H ₉	Rejected

Source: Output Data by SPSS (2020)

4. CLOSING

4.1. Conclusions

Earnings Management has no influence on Qualified Opinion.

Audit Quality has no influence on Qualified Opinion.

Audit Tenure has no influence on Qualified Opinion.

Company Size has no influence on Qualified Opinion.

Leverage has no influence on Qualified Opinion.

Liquidity has no influence on Qualified Opinion.

Inventory has no influence on Qualified Opinion.

Losses has no influence on Qualified Opinion.

Profitability has no influence on Qualified Opinion.

These results are also supported by several journals which stated that the independent variables in this research do not affect the Qualified Opinion.

4.2. Discussions

Earnings Management has no influence on Qualified Opinion. This result is consistent with [2] [10] [15] [19], but not with [1] and [20] which stated that Earnings Management has a negative influence on Qualified Opinion. Then, this study has no consistency with [21] [22] [23], which stated that Earnings Management has a positive influence on Qualified Opinion.

Audit Quality has no influence on Qualified Opinion. This result is consistent with [2] [24] [25] [26] [27] [28] [29], but not with [1] [12] [22] [28] [30] which stated that Audit Quality has a negative influence on Qualified Opinion. This study is not consistent with [15] stating that Audit Quality has a positive influence on Qualified Opinion.

Audit Tenure has no influence on Qualified Opinion. This is consistent with [26], but not with [1] [31] [32] [33] which stated that Audit Tenure has a negative influence on Qualified Opinion. This study has no consistency with [27]

stating that Audit Tenure has a positive influence on Qualified Opinion.

Company Size has no influence on Qualified Opinion. This result is consistent with [2] [28] [33] [34] [35], but not with [1] [12] [20] [36] which stated that Company Size has a positive influence on Qualified Opinion. This study has no consistency with [32] [37] [38].

Leverage has no influence on Qualified Opinion. This study is consistent with [1] [15] [23] [36] [39], but not with [32] which stated that Leverage has a positive influence on Qualified Opinion. This study has no consistency with [40], which stated that Leverage has a negative influence on Qualified Opinion.

Liquidity has no influence on Qualified Opinion. This study is consistent with [1] [41] [42], but not with [32] [40] [43] which stated that Liquidity has a negative influence on Qualified Opinion. [38] stated that Liquidity has a positive influence on Qualified Opinion.

Inventory has no influence on Qualified Opinion. This study is consistent with [1], but not with [32] stating that Inventory has a positive influence on Qualified Opinion. [2] stated that Inventory has a negative influence on Qualified Opinion.

Losses has no influence on Qualified Opinion. This study has no consistency with [1] [2] [15] [23] [28] [29] [32] [34] [42] [44] which stated that Losses has a positive influence on Qualified Opinion.

Profitability has no influence on Qualified Opinion. This study is consistent with [10], but not with [15] [25] [34] [38] [40] [41] [43] [44] [45] which stated that Profitability has a negative influence on Qualified Opinion.

4.3. Limitations and Recommendations

This study has several limitations, First the research year of financial statements is relatively short, which only uses 6 years (2013-2018). Next, this study only focused on manufacturing companies listed in the IDX. Finally, the variables are limited to only nine variables in this study,

while other variables may affect the Qualified Opinion as well.

The researchers recommend further research with more updated and longer research period, larger research object, and by adding or replacing other variables that might influence the Qualified Opinion.

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