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THE INFLUENCE OF COMPANY CHARACTERISTICS AND AUDITOR REPUTATION TOWARD THE ACCEPTANCE OF *GOING CONCERN* AUDIT OPINION

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Abstract

Enterprises Scandals happened in recent years cause suffer of financial loss. The scandal is caused by the public's ignorance toward the actual condition of the company. Auditors tend to provide wrong information about the company financial condition, so the stakeholders make wrong decision. Thus, SPAP must require a clear statement of the auditor on the condition of the client company, whether they will be able to survive until the next year or not. A condition whether the companies could maintain their lives until the next financial year is called going-concern.

By identifying going concern, hopefully enterprises or companies can improve their financial conditions. The aim of this study is to analyze factors of going concern such as financial condition, company size, previous audit opinion, the company growth and auditor's reputation on Indonesian manufacturing industries by using logistic regression.

There are a total of 155 companies as a research population. By Using a purposive sampling method, 128 companies are selected as samples. Five years company's annual report during 2007 to 2011 is used as a secondary source of data of this research. The findings indicate that the financial condition, previous audit opinion and auditor reputation infulence the acceptance of going concern. While, the size, company growth and opinion shopping do not have any influence.

Keywords: going concern, size, opinion shopping, company growth, the previous audit opinion, the auditor reputation, JEL classification codes: G3

INTRODUCTION

Background of Problems

The existence of accounting scandals at large corporations causes harm and loss to a lot of parties. The scandal is caused by the public's ignorance toward the actual condition of the company. Actually, the scandal can be avoided through providing transparent information by public accountants (auditors) who conduct the inspection of financial statements (audit). If cases of fraud are found there, then *SPAP (Standar Professional Akuntan Publik)* must require a clear statement of the auditor on the real condition of the client company, whether they will be able to have *a going concern* until the next financial year or not (Januarti, 2009).

Going concern is an opinion issued by the auditor to ascertain whether the company can maintain its viability or not (SPAP 2001 in Januarti 2009). The exifstence of *going concern* opinion to a company means that the ability of the company's business in the future is no longer promising, or in other words, the entity has already been on the verge of bankruptcy. This caution is necessary to be noticed by the users of financial

statements in making investment decisions. Hence, an investor needs to really know the financial condition of the company, especially as related to their survival before deciding to invest (Hany *et al,* 2003, in Januarti , 2009).

Some studies on the *going-concern* audit opinion reveals mixed results. Januarti (2009) finds that the debt default, firm size (size), the audit client tenure, the previous year opinion and the auditor quality influence the acceptance of *a going concern* opinion. While the variable of audit lag, opinion shopping, as well as managerial and institutional ownership do not influence the acceptance of *the audit going concern.* Furthermore, Dewayanto (2011) states that the financial condition, the previous year's audit opinion and the auditor reputation significantly influence the acceptance of *a going concern opinion.* While the size of the company, *the auditor client tenure,* and the *opinion shopping* has no influence on it.

In addition, Widyantari (2011) concludes that liquidity, profitability, cash flow, firm size, the growth of company and *the auditor client tenure* negatively affect the *going concern* audit opinion. Meanwhile, *leverage,* the audit quality, the audit *lag,* and the previous year's audit opinion positively influence the *going concern* audit opinion. Yet, Kartika (2012) concludes that the financial condition, the audit quality and *opinion shopping* do not influence the *going concern* audit opinion. While the previous year's audit opinion and the growth of the company influence the *going concern* audit opinion. In the same period, Ekasari (2012) states that the variables of bankruptcy prediction model, *debt default,* and the previous year opinion influence the *going concern* audit *opinion.*

The diversity of existing research results makes this topic interesting to be studied again. Hence, this study intends to re-examine the influence of company characteristics and auditors reputation toward the acceptance of *going-concern* audit opinion with reference to the study by Dewayanto (2011). However, there is a difference with previous studies; that is in the observation period of the companies listed in the Indonesia Stock Exchange from 2007-2011.

HYPOTHESES FORMULATION

Financial Condition

The financial condition of a company is defined as a whole view over financial condition of a company during a certain period. Media applied to assess the financial condition of a company is the financial report consisting of the balance sheet, statement of income, retained earnings overview, and the statement of financial position (Ramadhany, 2004). The more disturbed or deteriorated condition of the company is, the more likely the company will receive a *going-concern* audit opinion. In contrast, for companies that have never experienced any financial difficulties, auditors will have never issued a *going concern* audit opinion for them (Mckeown *et. Al.,* 1991 in Dewayanto, 2011). This statement is supported by Januarti (2009), Dewayanto (2011) and Widyantari (2011) who find evidence that the financial condition of a company influences the acceptance of a *going-concern* audit opinion. Based on the explanation above, the hypothesis proposed is as follow:

$H_{1:}$ The financial condition of a company positively influences the acceptance of a *going-concern* audit opinion on the manufacturing company.

Company Size

Firm size is defined as a scale to classify companies into large and small companies according to various ways, such as: total assets of a company, the value of the stock market, the average level of sales, and the number of sales (Machfoedz, 1994 in Widyantari 2011). A company with large total assets indicates that the company has reached a stage of maturity because in this stage the company has a positive cash flow and considered to have good prospects in a relatively long period of time to generate profits than the small ones. Setyarno, et al (2006) finds that there is a negative correlation of the firm size and *going-concern* audit opinion. The larger the company's assets are, the less likely the company will receive a *going-concern* audit opinion. Based on the explanation above, the hypothesis proposed is as follow:

$H_{2:}$ Firm size negatively influences a *going concern* audit opinion on the manufacturing company.

The Previous Year Audit Opinion

The previous year's audit opinion is defined as audit opinion received by the company in the previous year or the year before the study. *Auditee* who receives *a going concern* audit opinion on the previous year will be considered to have survival problems, so the auditor is more likely to issue an audit opinion for the ongoing year (Mutchler, 1984 in Dewayanto, 2011). This statement is supported by Januarti (2009), Dewayanto (2011), and Widyantari (2011) who find evidence that the previous year's audit opinion significantly infuence the *going concern* audit opinion on the manufacturing company. Based on the explanation above, the hypothesis can be formulated as follows:

$H_{3:}$ The previous year's audit opinion positively influences the *going-concern* audit opinion.

The Growth of Company

This ratio shows the company's ability to increase and maintain sales amid competition. The higher sales growth than the increase of costs will lead to the increase of profits. Total income earned on a regular basis and a tendency or trend of increasing profits is a crucial factor to determine the survival of a company. Yet, a company with negative sales growth ratio potentially experience a huge decreased profit, so that if management does not immediately take corrective action, the company will not be able to maintain their survive.

A trend which tends to increase sales show a good performance of management, which also means an increase in the company's financial performance. This will lower the risk of *going-concern* audit opinion. Yet, a negative *sales growth ratio* indicates the inability of the company to survive amid competition. This indicates that the company is not growing and likely to run a deficit profit thereby potentially receives *a going concern* audit opinion. This fact is supported by Widyantari (2011) which states that the sales growth negatively influences a *going concern* audit opinion. Based on the explanation above, the hypothesis is:

$H_{4:}$ The Growth of a Company negatively influences a *going concern* audit opinion on the manufacturing company**.**

Opinion Shopping

Opinion Shopping is defined as activity to search for auditors who want to support the accounting treatment proposed by the management of a company to achieve the purpose of company report. The substitution of auditors is used by companies to avoid *going concern* audit opinion (Dewayanto, 2011). This is supported by Januarti (2009), Dewayanto (2011), and Widyantari (2011) who find evidence that the *opinion shopping* negatively influence a *going-concern* audit opinion. Based on the explanation above, the hypothesis is:

$H_{5:}$ *Opinion Shopping* negatively influences a *going concern* audit opinion on the manufacturing company.

Auditor Reputation

Auditor reputation is defined as the performance of auditors in providing a *going concern* audit opinion based on the findings of the evidence obtained when auditing companies. Clients usually perceive auditors from a large public accounting firm and with the high-quality affiliation in international public accounting firm because they have characteristics associated with quality, such as training, international recognition and the *peer review* to issue a *going-concern* audit opinion (Fanny and Saputra, 2005). This is supported by Dewayanto (2011) who finds evidence that auditor reputation positively influence a *going-concern* audit opinion. Based on the explanation above, the hypothesis can be as follows:

$H_{6:}$ Auditor reputation positively influences a *going concern* audit opinion on the manufacturing company.

METHODS

Population and Sample

The population used in this study is manufacturing companies listed in the Indonesia Stock Exchange in 2007 to 2011. The sampling uses *purposive sampling* technique with the following criteria: (1). Companies should issue financial statements for December 31 in the range of 2007-2011, (2). Companies receive *going concern* audit opinion during the period of observation, (3). They have independent auditor's report published along with the period of observations, and received opinion can be in the form a *going concern* and *non-going concern,* (4) .Companies must have organizational structure that indicates the existence of internal divisions of auditors, (5) company stocks are actively traded in the BEI. Finally, based on the existing criteria, it is obtained a sample of 128 companies.

Definitions of Operational Variables

1. Dependent Variable

Going Concern Audit Opinion

Going concern audit opinion is defined as an opinion issued by the auditor to determine whether a company can maintain its survival or not (SPAP, 2001 in Januarti 2009). The dependent variable is presented as a *dummy* variable; that is a variable with categorical or dichotomous characteristics (Ghozali, 2006). The category used in this study is a category 1 to a company receiving a *going concern* audit opinion and categories 0 to companies receiving a *non going-concern* audit opinion.

2. Independent Variables
   a. Financial Condition

The financial condition of a company is defined as a whole view over the financial condition of a company during a certain period. This measures the company to maintain the survival of their business (Dewayanto, 2011). The Financial condition in this study is measured with *Z score* model (Altman, 1993) in Dewayanto (2011).

b. Company size

Company size in this study is measured by the logarithm of total assets. Total assets are chosen as a proxy on the size of the company taking into account that the value of assets is relatively more stable than the *market capitalized* and the sales value (Sudarmaji and Sularto, 2007).

c. The Previous Year Audit Opinion

Previous year's audit opinion is defined as audit opinion received by *the auditee* in the previous year, which is measured by using *a dummy* variable. Code 1 is given if *auditee* receives a *going concern* audit opinion, whereas if *the auditee* receives a *non going-concern* audit opinion, code 0 will be given as description (Ramadhany, 2004).

d. Growth Company

The company's growth is proxified by the ratio of sales and profit growth. The Sales growth ratio measures how well a company maintain its economic position, both in industry and the overall economic activity (Kartika, 2012). The sales growth ratio is used to measure the ability of *the auditee* to increase the rate of sales.

$$\text{The sales growth} = \frac{\text{Net Sales}_t - \text{Net Sales}_{t-1}}{\text{Net Sales}_{t-1}}$$

e. Opinion Shopping

Opinion shopping is measured by using the method applied by Lennox (2002). In Januarti (2011), it uses a *dummy* variable. Point 1 is given if the auditor make the turn when it gets a GC opinion, while point 0 is given if it does not make the turn when the auditor gets GC.

f. Auditor Reputation

Auditor reputation uses *a dummy* variable which is coded as 1 if the Accountant Public Office is affiliated with *the Big 4*, and coded 0 if not (Setyarno, 2006).

Analysis Techniques

The analytical tool used in this study is the logistic regression analysis. The reason for using logistic regression analysis is because the dependent variable is dichotomous (Where category 1 is for manufacturing companies that receive unqualified *going-concern* audit opinion and 0 for manufacturing companies that receive *unqualified non going concern*). The equation used in this study is as follows:

$$GC = \alpha + \beta\ 1\ \text{Bankrupt} + \beta\ 2\ \text{SIZE} + \beta 3\ 3\text{PO} + \beta 4\text{SALGR} + \beta 5\ \text{OS} + \beta 6\ \text{REPUT}$$

Specification:

GC = *Going concern*
α = Constant
Bankrupt = Prediction of bankruptcy
Size = Size of the company

PO = Previous year opinion
SALGR = the Growth of company
OS = Opinion shopping
Reput = Auditor reputation

FINDINGS AND DISCUSSION

Table 1
Result Analysis of Descriptive Statistics Research Variables

	N	Minimum	Maximum	Mean	Std Deviation
Size	128	5.05	7.67	6.2038	0.61356
SalGR	128	-0.90	10.60	0.3095	1.40964
ValidN (listwise)	128				

Source: processed data, 2014

The Size variable has a standard deviation value of 0.61356, it is smaller than the mean value of 6.2038. This means that the size of the company of each sample has nearly the same value. Meanwhile, the company's growth variable (SalGR) has the different statistics results. It has a standard deviation value of 1.40964 and it is greater than the mean value of 0.3095. This means that the growth of the company has a relatively small difference in magnitude among the sample Proposed.

Table 2
Results of Statistical Analysis of *Dummy* Research Variables

Variables	Criteria	%	Criteria	%
Financial Condition	High Risk	85.9	Safe	14.1
The previous audit opinion	*Going Concern*	80.5	*Non Going Concern*	19.5
Opinion Shopping	Doing Replacement	36.7	Not Doing Replacement	63.3
Auditor Reputation	Big 4 Firm Affiliate	68	Non-Big 4	32

Source: processed data, 2014

From the available data, a total of 85.9% companies are in the high-risk conditions or prone to bankruptcy and only 14.1% of companies which have issued in a safe condition (healthy). The number of companies in high-risk conditions followed by the release of the *going concern* audit opinion is 80.5%, while the remaining 19.5% get *non-going-concern* opinion. However, from the existing companies (mostly in high-risk conditions and obtain *going concern* opinion), it is only 36.7% that do replacement auditors, the remaining 63.3% still use the old auditor. From 128 companies, 68% of companies use auditors affiliated with the Big 4 Firms and the remaining 32% uses non-Big 4 Firms.

Table 3. Summary of Hypotheses Result

Hypothesis	Significant Value	Results
H_1: The financial condition positively influences a *going-concern* audit opinion on the manufacturing company.	0.006 <0.05	H_1 is accepted
H_2: Firm size negatively influences a *going concern* audit opinion on the manufacturing company	0.853> 0.05	H_2 is rejected
H_3: The previous year's audit opinion positively influences the *going-concern* audit opinion	0.005 <0.05	H_3 accepted
H_4: The Growth of Company negatively influences the	0.495> 0.05	H_4 rejected

going concern audit opinion on the manufacturing company		
H_5: *Opinion Shopping* negatively influences the *going concern* audit opinion on the manufacturing company	$0.952 > 0.05$	H_5 rejected
H_6: Auditors reputation positively influence the acceptance of *going concern* audit opinion on the manufacturing company	$0.035 < 0.05$	H_6 accepted

The influence of the financial condition toward the *company's going concern* audit opinion

The test results show that the company's financial condition affects the *going concern* audit opinion. The more disturbed or deteriorated condition of the company is, the more likely the company will receive a *going-concern* audit opinion. Whereas, for companies that have never experienced financial difficulties, auditors will never issue a *going-concern* audit opinion (Mckeown *et. al.,* 1991 in Dewayanto, *2011).* This is supported by Januarti (2009), Dewayanto (2011) and Widyantari (2011) who find evidence that the financial condition influences the *going concern* audit opinion. Furthermore, This finding supports the study by McKeown et al (1991) in Januarti (2009) which states that the auditors almost never issue a *going concern* opinion on companies that are not experiencing financial distress. The empirical finding in this study is not in line with the research by Kartika (2012).

The influence of firm size toward the *going-concern* audit opinion

The test results show that the size of company does not influence the revenue of *going concern* audit opinion. However, the sign of the regression coefficient values is in accordance with the proposed hypothesis (negative). The finding of this study provides evidence that firm size does not influence the *going concern* audit opinion. This happens because the company's growth is not followed by *the auditee's* ability to improve their balance in the assets of the company (Fitrianasari and Januarti, 2008). The finding of this study is in accordance with the study by Januarti (2009), Widyantari (2011), but not with the study by Dewayanto (2011).

The Influence of the previous year's audit opinion toward the *going-concern* audit opinion

The test result shows that the previous year's audit opinion influences the *going concern* audit opinion. The presence of the previous year's audit opinion is enough to determine whether the company gets a *going concern* audit opinion or not. The previous year's audit opinion is the type of audit opinion received in the previous year. There is a positive correlation of the previous year's audit opinion and *the ongoing going-concern* audit opinion of the current year. If in the previous year the auditor issued a *going concern audit* opinion, the auditor will likely provide *going concern* audit opinion in the current year. The finding of this study is in accordance with the study by Januarti (2009), Dewayanto (2011), Kartika (2012) and Ekasari (2012), but not in line with the finding by Widyantari (2011).

The influence of the company's growth toward *going-concern* audit opinion

The test result shows that the growth of company does not influence the *going concern* audit opinion. This study provides evidence that the other growth ratio, such as the ratio of positive sales growth cannot guarantee *the auditee* to not accept *the going concern* audit opinion. The sign of the coefficient of the company positive growth

variable indicates the positive correlation, which means that the higher the ratio of turnover growth of *auditee* is, the more likely the auditors issue *a going concern* audit opinion. The finding of this study supports the study by Widyantari (2011), but not in line with the study by Kartika (2012).

The influence of *opinion shopping* toward the *going-concern* audit opinion

The test result shows that *opinion shopping* does not influence a *going concern* audit opinion. The finding of this study is in line with the study by Januarti (2009), Dewayanto (2011), and Kartika (2012). It means that *the auditee* receiving *going concern* audit opinion will not change their auditors. The finding indicates that companies in Indonesia are less likely to receive *a going concern* opinion when the auditors are maintained well. This finding provides evidence that the condition in Indonesia is in accordance with the practice of *opinion shopping* expressed by Teoh (1992) in Dewayanto, (2011) about the threat argument to change auditors. As a result, the auditors will issue *a non going concern* opinion to maintain their client. This argument is in line with the opinion of Lennox (2000) in Kartika (2012), where said that although companies often replace auditors after receiving a *going concern* opinion, it remains unclear whether this practice reflects the *opinion shopping*. Even, the high possibility of *opinion shopping* still happens to the company that maintains the old auditor. This empirical evidence shows the indication of a lack independence of auditors in Indonesia.

The influence of auditor reputation on the *going-concern* audit opinion

Test result shows that the auditor reputation influences *going-concern* audit opinion. The finding of this study is in line with the study by Dewayanto (2011) but not in line with the Kartika (2012). This means that the scale of auditor reputation simply determines whether the company includes in *going concern* audit opinion or *non-going-concern*. The auditor reputation is based on trust service of the auditor users. Auditor reputation is often used as a proxy on auditor reputation, but in the competence and independence of research, it is still rarely used to detremine how well the reputation of auditors in the actual is (Widyantari, 2011).

A large scale auditor can provide more auditor reputation than the small one, including in the case of *going concern*. The larger the scale of the auditor is, the more likely the auditor auditors issue a *going concern* audit opinion.

Clients usually perceive that auditors from a large public accounting firm and with International affiliation have higher quality because they have characteristics that can be associated with quality, such as training, international recognition and the *peer review*. The Auditor Reputation increases with the size of the public accounting firm. The Increasing reputation of auditors will heighten the scale of public accounting firm. As a result, it will also influence the client to choose public accounting firm.

CONCLUSIONS AND IMPLICATIONS OF RESEARCH

Based on the findings and discussion, it can be concluded that the variables of financial condition, the previous year's audit opinion and auditor reputation influence the *going concern opinion*. While the variable of the size, the growth of the company and *opinion shopping* does not influence a *going concern opinion*. This is happening due to several limitations in the study, such as: (1). this study uses the measure tool of Altman discriminant analysis to measure the financial condition of company. As a

result, thera many companies includes in the category of bankrupt, yet , they still run their operations. (2). in performing the audit process, auditors only pay attention to the things revealed in the annual financial statements. Having regard to some limitations of the study submitted, it can be given suggestions for further study, as follows:

1. Other measurement tools need to be explored for existing variables.
2. The further resesarcher is recommended to add new variables such as audit client tenure

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