

Audit Quality as a Moderating Effect of Financial Condition On Going Concern Modified Audit Opinion

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Abstract – The purpose of this study is to examine audit quality as a moderating effect of financial condition on going concern modified audit opinion. The study sample consisted of 50 service companies in the IDX for period 2013-2017 with purposive sampling method. Logistic regression and Moderated Regression Analysis (MRA) is used as a data analysis technique and hypothesis testing through program SPSS v.23. The results found out that the financial condition does not affect the going-concern audit opinion. Audit quality reinforces the effect of financial conditions on going concern audit modified opinion. The result of this study will contribute for the improvement of information auditor in the analysis financial report and opinion audit. It will also enrich knowledge in information for investor and management.

Keyword – Financial Condition, Audit Quality, Audit Opinion, Auditor, Going Concern.

I. INTRODUCTION

The existence of the public accounting profession in Indonesia is actually inseparable from its development, where the number has always increased from the last few years. According to [1] the more public companies there are, the more public accounting services are needed. The desire of public companies to present their financial statements fairly is one of the causes of the many needs for public accounting services.

Financial statements that must be prepared must be based on a basic concept, one of which must meet the going concern assumption [2]. The procedure for using the going concern assumption itself is contained in Audit Standard No. 570, where the audit standard is an indication of the auditor's responsibility in the audit of the financial statements regarding the use of the assumption of "sustainable effort" and management's assessment of the entity's ability to continue its business [3].

The going concern opinion expenditure by the auditor shows that a situation where the company is experiencing bad financial condition. One of the bad financial condition of the company is the negative trend such as operational loss, negative cash flow, negative working capital and negative retained earnings, in which case the company will likely receive a going concern modified audit opinion. These conditions will lead to doubts for auditors about the company's ability to maintain going concern.

The phenomenon related to financial condition with going concern audit opinion in Indonesia is a service company engaged in the transportation industry namely Batavia Air in 2012 where in that year the Batavia Air airline was unable to pay its debts of \$ 4.68 million which would be due, because Batavia Water does not make payments, so the creditors filed for bankruptcy. Where before Batavia Air went bankrupt, its financial statements showed the ability to pay short-term and long-term obligations and cash flow in good condition. His financial statements also received an unqualified opinion and there was no disclosure of the going

concern modified audit opinion paragraph in 2011. However, it turned out that Batavia Air could not maintain going concern modified audit opinion so that it went bankrupt [4]. In this Phenomena it can be explained that the auditor's negligence in responding to the survival of the company and providing inaccurate information that resulted in the bankruptcy of Batavia Air and also losses for investors.

Research conducted by Altman and McGough [5] found that the prediction level of financial conditions can be measured using a prediction model reaching an accuracy level of 82% and recommends that the use of a financial condition prediction model as a measurement tool help the auditor to assess the company's ability to maintain its survival. The earlier signs the company will go bankrupt, the better it is for management to make improvements. The creditor and also the shareholders can make preparations to overcome the various bad possibilities that will occur later. Financial conditions that show signs of bankruptcy can be seen using accounting data [6]. Thus, the data obtained must be relevant and accurate, so that it will produce a quality information.

Quality of information that is where an information must be accurate that is free from errors and not biased or misleading its users, but it must also be timely and relevant. Many data manipulations in the financial statements that escape the attention / testing of auditors can be interpreted as audit failures that occur due to low audit quality. Audit quality is related to the ability of auditors to find, eliminate and report misstatements and manipulations in financial statements [7]. Audit quality can also be seen from the point of view of accounting restatement. Restatement is done because the financial statements contain material misstatement or presentation that is not in accordance with accounting standards [8].

II. LITERATURE REVIEW AND HYPOTHESIS

2.1 Literature Review

2.1.1 Going Concern Audit Opinion

According to [9], going concern is a proposition stating that an entity will continue its operations for a long time to realize its projects, responsibilities, and endless activities. So according to [10] reveals several criteria the company will receive a going concern audit opinion. These criteria are if having problems with income, reorganization, inability to pay interest, receive a going concern opinion the previous year. In addition, companies that are in the process of liquidation have negative capital, negative cash flow,

negative operating income, negative working capital, 2 to 3 consecutive years of loss, and negative retained earnings.

According to the SPAP the audit opinion included in the going concern (GC) opinion is unqualified with paragraph explanatory language, qualified opinion, adverse opinion and opinion disclaimer. The following is a guide for the auditor in issuing a going concern opinion [11].

2.1.2 Financial Condition

The financial condition of the company is a complete view or condition of the company's finances for a certain period of time. The company's financial condition describes the real financial condition of the company [12].

According to [10] reveals that there are several characteristics of a problematic company, including companies having negative total capital, negative cash flow, negative operating income, and negative working capital, current year losses, and current account balance deficit.

Indicator of measurement of financial condition is modified Altman Z Score:

$$Z'' = 6,56X_1 + 3,26X_2 + 6,72X_3 + 1,05X_4$$

Explanation:

- Z'' : bankruptcy index
- X₁ : net working capital/ total asset
- X₂ : retained earnings/ total asset
- X₃ : EBIT/ total asset
- X₄ : book value of equity/ total liabilities

2.1.3 Audit Quality

According to [13] defines auditor quality as the probability of an auditor finding and reporting on audit findings in his client's accounting system. So according to [14], and [15], define audit quality as the ability of auditors to detect and eliminate misstatements and manipulations in financial statements. And then, [16] defines that audit quality is determined by the ability of auditors to reduce noise and bias and increase fineness in accounting data.

The big four firms will try to present greater audit quality compared to non big four firms. With the selection of high quality auditors that are considered able to increase the level of credibility of the financial statements, auditors from the big four firms tend to be more willing to issue a going-concern audit opinion on companies that really should get that opinion [13].

The quality of auditors in this study was measured using dummy variable. Number 1 is given to companies that use the services of firms affiliated with big four firms. While the number 0 is given to companies that use firms services that are not affiliated with non big four firms.

2.1.4 The Effect of Financial Condition on Going Concern Audit Opinion

Companies that have good financial conditions, marked by an increase in profits each year, although not significant, of course, this will have an impact on the granting of a smaller going concern modified audit opinion. Conversely, if the company has a bad financial condition, marked by losses each year, so it will have an impact on the minus working capital which results in the current ratio being smaller than one and the company is considered illiquid because it is considered unable to finance its short-term obligations, the greater the chance of receiving an opinion going concern audit modified.

The results of previous studies conducted by [17], and [18] that financial conditions affect the going concern audit modified opinion. The company's financial condition is a view or the whole condition of the company's finances for a certain period of time. The company's financial condition reflects the actual financial condition of the company.

2.1.5 Audit Quality Strengthnes the Effect of Financial Condition on Going Concern Modified Audit Opinion

Financial conditions that show signs of bankruptcy can be seen using accounting data [6]. Thus, the data obtained must be relevant and accurate, so that it will produce a quality information. Quality of information that is where an information must be accurate that is free from errors and not biased or misleading its users, but it must also be timely and relevant. Many data manipulations in the financial statements that escape the attention / testing of auditors can be interpreted as audit failures that occur due to low audit quality. Audit quality is related to the ability of auditors to find, eliminate and report misstatements and manipulations in financial statements.

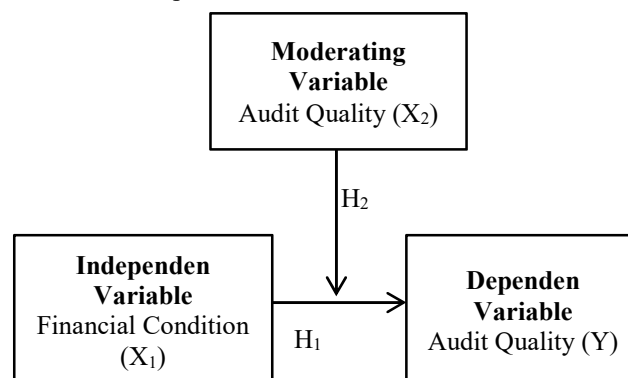
Then results of previous studies conducted by [19] that audit quality measured by firms' size proves that audit quality affects going concern modified audit opinion.

2.2 Hypothesis

2.3 Based on the literature review it's suspected:

2.4 H₁: Financial condition affects the going concern modified audit opinion.

2.5 H₂ : Audit quality strengthens the effect of financial conditions on going concern modified audit opinion.



III. RESEARCH METHODOLOGY

This study was conducted on service companies listed on the Indonesia Stock Exchange for period 2013-2017. The population used in this study is as many as 318 service companies. The sample determination technique in this study was carried out by purposive sampling method, there are as many as 50 companies that are sampled with five years of observation. So that the total amount of this research is 265 samples.

This study was tested using logistic regression analysis because the dependent variable was measured using a dummy variable, so the researcher chose to use the test tool to determine the effect of 2 independent variables, going concern audit opinion and non going concern audit opinion. The Moderated Regression equation used in hypothesis testing is as follows:

$$\ln \frac{GC}{1 - GC} = \alpha + \beta_1 X_1 + \varepsilon$$

This study also uses moderating variable. The moderating variable agreed will prove whether to support or weaken the relationship between the independent and dependent variables. The method of testing moderating variables in this study uses the interaction test or commonly referred to as Moderated Regression Analysis (MRA).

The Moderated Regression equation used in hypothesis testing is as follows:

$$\ln \frac{GC}{1 - GC} = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_1 \cdot X_2 + \varepsilon$$

Explanation:

$\ln \frac{GC}{1-GC}$ = Going Concern Modified Audit Opinion
 Dummy Variable (category 1 (one) for *going concern* and 0 (zero) for *non going concern*)
 α = Regression Constant
 β_i = Regression Coefficient,
 where $i = 1, 2, 3$
 X_1 = Financial Condition
 X_2 = Audit Quality
 ε = Error

IV. RESULT AND DISCUSSION

4.1 Result

The analysis used in this study is logistic regression analysis (logistic regression) and then in this study uses the interaction test or commonly referred to as Moderated Regression Analysis (MRA). Namely by looking at the audit quality strengthens the effect of financial conditions on going concern modified audit opinion.

Table 4.1 Logistic Regression Model Test

Variables in the Equation		B	S.E.	Wald	df	Sig.	Exp(B)
Step 1 ^a	Financial Condition (X1)	,001	,001	,212	1	,645	1,001
	Audit Quality (X2)	-,298	,322	,854	1	,355	,743
	X1.X2	-,076	,029	6,885	1	,009	,927
	Constant	-,494	,167	8,786	1	,003	,610

a. Variable(s) entered on step 1: Financial Condition (X1), Audit Quality (X2), X1.X2.

Source: data processing IBM SPSS Ver. 25, 2019

The first hypothesis states that financial conditions affect the going concern modified audit opinion. Based on Table 4.1 variable financial condition shows a positive coefficient of 0.001 with a significance of 0.645 greater than 0.05. This means that the first hypothesis is rejected, which means the financial condition does not affect the going concern audit opinion.

The second hypothesis states that audit quality reinforces the effect of financial conditions on going concern modified audit opinion. Based on Table 4.1 variable financial conditions multiplied by audit quality shows a negative coefficient of -0.076 which means that the presence of audit quality variables strengthens the effect of financial conditions on going concern modified audit opinion with a significance of 0.009 smaller than 0.050. This means that the second hypothesis is accepted, which means that audit quality reinforces the effect of financial conditions on going concern modified audit opinion.

4.2 Discussion

4.2.1 Effect of Financial Conditions on Going Concern Audit Opinion

The test results using logistic regression showed a positive coefficient of 0.001 with a significance level of 0.645 which is greater than $\alpha = 5\%$ ($0,000 < 0.05$). This shows that the variable financial condition does not affect the going-concern audit opinion in other words H_1 is rejected. This means that if the company is in a bad financial condition, it is not certain that the company will receive a going concern modified audit opinion. The results of this study do not support the results of previous studies conducted by [17], and [18] which state that companies that experience poor financial conditions will receive a going concern audit modified opinion. However, the results of this study support the results of research conducted by [20] which state that bad financial conditions do not affect the going-concern modified audit opinion.

4.2.2 Audit Quality as Moderating Effects of Conditions on Going Concern Audit Opinion

The test results using moderation regression showed a negative coefficient of -0.076 with a significance level of 0.009 which is smaller than $\alpha = 5\%$ ($0,000 < 0.05$). Based on the results of this test indicate that audit quality variables that support financial opinion in the audit opinion will occur in other words, H_2 . This means that if the company is in poor financial condition, it is not certain that the company will accept the audit opinion of the ongoing modification.

This means that if the company is in bad financial condition, it is not certain that the company will accept the going concern modified audit opinion. The results of the study support the results of research previously conducted by [19].

V. CONCLUSION

Based on the result of research and discussion can be concluded that:

- Poor financial conditions do not affect the auditor in issuing a going concern modification audit opinion, this is because the auditor not only looks at bankruptcy predictions, but looks at the company's overall finances and management plans to overcome these problems.
- Poor financial condition tends to show signs of unfavorability in the company so that it has an impact on business continuity, this can be seen by using accounting data. Thus, the data must be relevant and accurate, so that it will provide a quality information. Audit quality is related to the auditor's ability to find,

eliminate and report misstatements and manipulations in financial statements. In maintaining the quality of its audit, the big four Firm's will provide a going concern audit modification opinion on companies that are considered to have poor financial conditions. Because the greater the scale of the auditor in conducting the audit, the greater the auditor will choose an audit opinion will occur.

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