

Conference Paper

The Analysis of Auditor Opinion After Financial Crisis

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Abstract

The 2008 global financial crisis impacted Indonesian economy, especially manufacturing companies due to their contributions around 21.3% to Indonesian economy as per the United Nation Statistic Division. This research aims to find out the extent of manufacturing company performance after financial crisis on the auditor side. Therefore, the influences of corporate governance (CG), earning management (EM), and firm value (FV) on audit opinion is conducted. Out of 154 manufacturing companies listed in capital market, 37 of them were listed after the 2008 financial crisis and 38 of them did not report their financial statements in 2008. Hence, this research is conducted on 79 public manufacturing companies that were able to overcome the 2008 financial crisis. The result is beyond expectation because auditor's opinion is not influenced by corporate governance and also without regard to earning management practices, but auditor's opinion is influenced by the firm value although firm value is influenced by corporate governance and earning management practices. The result indicates the extent to how the auditor determines the results of the auditor's opinion and improvements that need to be made throughout the audit process.

Keywords: financial crisis, corporate governance, earning management, firm value, audit opinion

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1. Introduction

The impact of the 2008 financial crisis was perceived by all countries in the world including Indonesia where economic growth fell from 6% to 4.5% [1](Badan Pusat Statistik, 2009)) due to company performance degradation, especially manufacturing companies which has the biggest contribution to Indonesia economy. In 2008, manufacturing sector contributed 27.9% and decreased to 26.3% in 2009 which resulted in a significant slowdown from 3.7% to 1.6% [2](World Bank, 2009). This crisis ended in unstable company performance which was reflected in the financial statements. This condition made investor considered their investment decisions.

As a result, company management will strive to increase investor belief by conducting earning management practices [3](DeAngelo et al., 1994) to create perceptions that

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company condition is not affected by financial crisis. This incident becomes auditor's concern in assessing company financial statement. Audit opinion becomes a source of public trust in the credibility and reliability of the information contained in financial statement. Therefore, Baird [4](2000) states that the role of corporate governance need to be concerned. Good corporate governance can decrease potential of earning management practices. Thus, the purpose of this research is to determine the extent of manufacturing companies performance after financial crisis on the auditor side.

2. Literature Review and Hypothesis

2.1. Conceptual model

2.1.1. Corporate governance (CG)

Corporate governance become an interesting topic in Indonesia since financial crisis. Inadequate corporate governance can lead to company liquidation [4](Baird, 2000). Corporate governance can be defined as the structure, system and process used by the organs of the company as an effort to provide sustainable value added [5](ICG, 2010). Corporate governance regulates tasks, rights and obligations to those whom contributes in the company sustainability. Behavior of both internal and external parties will determine corporate governance quality.

2.1.2. Earning management (EM)

In economic hardship such as financial crisis, earning management becomes a tool for management to manage numbers in financial statement as the impact of crisis [6](Berndt and Offenhammer, 2011). Earning management is a practice of income or income identification time so that income streams changed but does not increase in long term [7](Fudenberg and Tirole, 1995). Earnings management occurs when managers use valuations in financial reporting and in structuring transactions to change financial statements both mislead some stakeholders about the economic performance that underlies the company and affect the outcome of contracts that depend on the accounting numbers reported [8] (Healy & Wahlen, 1999).

The nature of accrual accounting gives managers the wisdom in determining the actual profit reported by the company. The manager can change the recognition time of income and expenses. In this case, managers will most likely be involved in earnings

management because they have the power to control financial statements [9] (Goel, 2016).

2.1.3. Firm value (FV)

Company long term goal is to optimize the company value by minimizing costs of capital. Higher value will be followed by higher shareholder's prosperity [10] (Brigham and Gapenski, 1996). There are three types of valuation related to stocks: book value, market value and intrinsic value. This valuation aims to increase investor awareness when making investment decisions [11]. Higher value can create public trust in company prospects in the future.

2.1.4. Audit opinion (AO)

Auditor is in charge of forming an opinion based on the evaluation of conclusions drawn from the audit evidence obtained and clearly states that opinion through a written report. The opinion formed must be qualified and unqualified. Audit is an efficient mechanism which can determine whether the manager is running in accordance with the interests of shareholders or not [12] (Rezaei and Shahroodi, 2015).

2.2. Hypothesis development

Characteristics of corporate governance and the legal system of investor protection can also influence the role of legal auditors [13] (Piot, 2001). [14] argue that high accrual companies are more likely to experience future earnings reversals and SEC enforcement actions for GAAP violations, but investors do not appear to anticipate these consequences. This enforcement is based on audit opinion on the company's financial statements. The results of earnings quality test and the credibility of financial reporting, they found no evidence that auditors indicated the possibility of higher GAAP violations through their audit opinions.

H1: Corporate governance has an influence on audit opinion.

Based on previous research related to the relationship between earnings management and certain corporate governance practices, including the composition of the board and audit committee, the relationship between Corporate Governance and Earning Management is inversely proportional, earnings management will decrease along with the increase in corporate governance [15–21] (Agrawal and Chadha, 2005;

Beasley, 1996; Chtourou et al., 2001; Davidson et al., 2005; Klein, 2002; Peasnell et al., 2005; Vafeas, 2005).

According to [22], there are three main factors that influence the company activities in relation to the relationship between CG and EM, namely managerial ownership, board composition and audit committee. Some corporate governance mechanisms are often used in research to determine its effect on earnings management. The first is the effectiveness of the board of directors in carrying out its functions because compliance with accounting standards is not enough to ensure there is no manipulation in financial statements [23] (Saleh et al., 2005). Second, the form of corporate governance, such as structure and composition in effectively handle its monitoring responsibilities [20] (Peasnell et al., 2005), or it may depend on the substance of corporate governance, such as the persistence and directors' bustle [24, 25], the proportion of independent commissioners and audit committees will also help improve the financial reporting process [26] (PGC, 2006).

H2: Corporate governance has an influence on earning management.

The role of auditor is to ensure that financial reporting has high quality. Audit committee served for supervise financial reporting and earning management practices. Auditees with high accrual rates will most likely to receive qualified audit opinion. Accruals are subjective estimates of managers for future results, so auditees with high accrual rates have greater uncertainty than auditees with low accrual rates. Thus, auditor will be more likely to issue qualified audit opinions for auditees with high accrual rates [27] (Francis and Krishnan, 1999).

H3: Earning management has an influence on audit opinion.

As mentioned before, companies need to maximize their value. Agency conflict will be appeared when shareholders rely on managers to provide services on their behalf [28] (Jensen and Meckling, 1976). Whereas from research conducted by [29] You et al. (2003), agency problems arise when a manager has a shareholding of less than the total equity of the company. To overcome this problem, companies need to implement corporate governance. Corporate governance develops by relying on agency theory, where the management of the company must be supervised and controlled to ensure that the management is carried out in full compliance with the applicable rules and regulations.

The rise and fall of corporate values and to reduce agency costs are influenced by the ownership structure. [28] Jensen and Meckling (1976), states that the agency conflict will occur when top managers' proportionate shares of the company is less than 100%

so it tends to act to pursue their own interests and is not based on maximizing the value in making funding decisions.

H4: Corporate governance has an influence on firm value.

Firm value is used as a perception for investors in assessing the company feasibility. One aspect that investors value over the company's value is the transparency expressed in the company's annual report. Therefore, auditors are very reliable in providing good information for investors [30] (Deegan, 2004).

H5: Firm Value has an influence on audit opinion.

Earning management strategy is used for increasing reported earnings in the current period to make the company look better. Earning management conducted by company management will increase the value of the company (Tobin's Q) [31] (Morck Scheifer and Vishny, 1988).

H6: Earning Management has an influence on Firm Value.

3. Research Design

3.1. Sample

Data used in this research is annual report from manufacturing companies which are listed in Indonesia Stock Exchange in 2009 – 2017. Criteria for data used are companies which have done their Initial Public Offering (IPO) before the 2008 crisis and companies which provided thorough annual reports from 2009 – 2017. Data that matched the criteria amounted to 79 companies.

3.2. Measurement of variables

Independent variables used in this research are *corporate governance*, *earning management* and *firm value* while audit opinion becomes dependent variable. The following is the operational definition of each variables:

3.2.1. Corporate governance

Corporate governance is measured using scoring techniques. Scoring is carried out on the audit committee, independent commissioners and management ownership.

3.2.2. Earning management

Earning management is measured using the Modified Jones Model formula for calculating discretionary accruals. This model is determined by [32] Dechow, Sloan, & Sweeney (1995) and extended by [33] Kothari, Leone, & Wasley (2005).

$$\text{Total Accrual (TACC)} = \text{NI} - \text{CFO}$$

The following formula is used to find the coefficient value:

$$\frac{TACC_{it}}{A_{it-1}} = \alpha_0 \frac{1}{A_{it-1}} + \alpha_1 \frac{\Delta REV_{it} - \Delta REC_{it}}{A_{it-1}} + \alpha_2 \frac{PPE_{it}}{A_{it-1}} + \alpha_3 ROA_{it} + \epsilon_{it}$$

After the coefficient is found, the following formula is used to calculate non-discretionary accruals:

$$NDA_{it} = \alpha_0 \frac{1}{A_{it-1}} + \alpha_1 \frac{\Delta REV_{it} - \Delta REC_{it}}{A_{it-1}} + \alpha_2 \frac{PPE_{it}}{A_{it-1}} + \alpha_3 ROA_{it}$$

Discretionary accruals is obtained by deducting total accrual and non-discretionary accrual:

$$DA_{it} = \frac{TACC_{it}}{A_{it-1}} - NDA_{it}$$

3.2.3. Firm value

According to [34] Siagian, Siregar, & Rahadian (2013) the firm value is measured using Tobin's Q with this formula:

$$\text{Tobin's Q} = \frac{MVE + D}{BVE + D}$$

3.2.4. Audit opinion

Audit opinion uses dummy variables. Companies which received a qualified audit opinion were given a score of 0 and the company which received an unqualified audit opinion was rated 1.

4. Analysis and Results

Data analysis techniques consist of validity, collinearity, reliability testing and hypothesis testing using WrapPLS. Analysis will be carried out with the help of WrapPLS software. Evaluation of the measurement results in the form of an outer model and inner model or

known as a structural model. The purpose of using WarpPLS is to predict the impact of the independent variable (X) on the dependent variable (Y) and to explain the relationship between these variable.

TABLE 1: DESCRIPTIVE STATISTICS.

	N	Minimum	Maximum	Mean	Std. Deviation
CG	711	2	3	2.505	0.5003
EM	711	-0.5	0.4	0.003	0.0845
FV	711	0.000793	0.81219	0.210	0.1767
OA	711	0.0	1.0	0.999	0.0375

Data of 79 manufacturing companies within 2009 – 2017 is used as sample with 711 observations. Description of earnings management variable produces an average value of 0.003 with a standard deviation of 0.0845, the lowest earning management is of -0.5 owned by ALMI company in 2015 while in 2014 ALMI had a high earning management of 0.399. Description of firm value variables produces an average of 0.21 with a standard deviation of 0.1767. The value of the lowest firm value is 0.001 owned by TBMS company at 0.000793 in 2013. The highest value is owned by the TIRT company in 2013, which amounted to 0.81219.

TABLE 2: STRUCTURAL EQUATION MODELS.

Relation Between Variables	Path Coefficients	P-values
CG → OA	0.025	0.254
CG → EM	-0.064	0.042**
EM → OA	0.013	0.369
CG → FV	-0.148	< 0.001***
FV → OA	-0.092	0.007***
EM → FV	0.096	0.005***

Note: ***significance at the 0.01 level; **significance at the 0.05 level.

Based on Table 2, the value of the path coefficients influence corporate governance on audit opinion is 0.025 with a P value of 0.254 which is greater than 0.1. It shows that there is no significant influence between corporate governance on audit opinion. Many companies do corporate governance in order to deal with crisis, but auditors do not see corporate governance as a reference in giving their opinions. The results of this research are supported by a research conducted by [35] Chandra (2013) which shows that CG has no significant influence on the provision of audit opinions. Based on the results of this study, the first hypothesis states that corporate governance has an influence on audit opinion is rejected.

The value of the path coefficients of corporate governance influence on earnings management is -0.064 with a *P*-value of 0.042 which is smaller than 0.05. This shows that corporate governance negatively significant to earning management. This means that the better corporate governance, the lower the earning management carried out by the company. Companies implement corporate governance to deal with crisis in order minimize manipulation action which can give a negative impact. The results of this study are supported by research conducted by [36] Abdillah et al. (2014) which shows that corporate governance has a negative effect on earnings management in manufacturing companies listed in the Indonesia Stock Exchange. Based on these results, the second hypothesis that suggests that corporate governance has an influence on earning management is accepted.

Based on the path coefficient value, the effect of earning management on audit opinion is 0.013 with *p*-values of 0.369 which is greater than 0.1. This shows that there is no significant influence between earnings management and audit opinion. It indicates that the auditor can't detect earning management practices carried out by the company when facing a crisis. The results of this research are similar to the results of previous research by [37] Tsipouridou & Charalambos (2013) which states that there is no significant relationship between Earning Management and Audit Opinion. Based on these results, the third hypothesis which states earnings management has an influence on audit opinion is rejected.

The coefficient path value of the influence of corporate governance on firm value is -0.148 with a significant level below 0.001 which is less than 0.01. This shows that corporate governance negatively significant to firm value. There will be many decisions that must be taken by management when facing financial crisis. An increase or change in the board of commissioners will affect Tobin's *Q*. The higher the number of commissioners, the lower the value of the company due to an agency conflict within the company. Every stakeholder has different interests and causes management decisions to be ineffective. In line with the research of [38] Wida & Suartana (2014) that managerial ownership cannot reduce agency conflicts in companies in Indonesia and [39] Fala's (2007) research shows that the management structure of companies in Indonesia has a cross directorship where there is a relationship between the company's board of commissioners and the company's other boards of commissioners, as a company commissioner A has a position in company B this can weaken the control and service functions of the board of commissioners. In this condition, investors will reconsider their investment decisions. Overall, the results of this study are supported by the research of [40] Sarafina & Saifi (2017) which suggests a significant relationship between corporate

governance and firm value. Based on these results, the fourth hypothesis which states that corporate governance has an influence on firm value is accepted.

The value of the path coefficients of firm value influence on the audit opinion is -0.092 with a *P*-value of 0.007 which is less than 0.01. This shows that firm value negatively significant to audit opinion. It means that the better company value does not affect the results of the audit opinion given by the auditor. The results of this study are contradictory to [41] Ardiana (2014) that good firm value tends to make companies get an unqualified audit opinion. Based on these results, the fifth hypothesis which states that firm value has an influence on audit opinion is accepted.

The path coefficients value of the influence of earning management on firm value is 0.096 with a *P*-value of 0.005 which is less than 0.01. This shows that earning management positively significant to firm value. Its means companies which implement earning management practices will increase the company value since investors respond positively to companies with great financial conditions. The company conducts earnings management during or after the crisis with the aim of attracting investors to invest. The results of this study are supported by research conducted by [42] Jiraporn (2008) and [43] Raoli (2013) which found a positive relationship between earnings management and firm value. However, [44] Junchristianti & Priyadi (2013) in their research shows that there is a negative relationship between earnings management and firm value. Based on these results, the sixth hypothesis which states that earnings management affects firm value is accepted and proven.

TABLE 3: CRONBACH'S ALPHA.

Variable	Cronbach's Alpha
Corporate Governance	1.00
Earning Management	1.00
Firm Value	1.00
Opini Audit	1.00

The value of Cronbach's Alpha has fulfilled the rule of thumb in all four variables, namely the value of Cronbach's alpha > 0.6. These results indicate that the model in this study is reliable.

TABLE 4: FULL COLLINEARTITY VIF.

Variable	Full collinearity VIF
Corporate Governance	1.027
Earning Management	1.010
Firm Value	1.037
Opini Audit	1.010

Based on the VIF value of each variable whose value is smaller than 5 and smaller than 3.3 indicates that the variable is ideal, acceptable and does not occur any multi-collinearity problems.

TABLE 5: R SQUARED.

Variable	R-squared
Earning management	0.004
Firm Value	0.032
Opini Audit	0.01

From the table above, it is known that the R-square value for earning management is 0.004, meaning that the large percentage of influence of corporate governance on earnings management is 0.4% while the remaining 99.6% is explained by other variables. The R square value for firm value is equal to 0.032, meaning that the percentage of the influence of corporate governance on the firm value is 3.2% while the remaining 96.8% is explained by other variables. From Table 5, the value of Q^2 can be calculated the following values:

$$\text{Nilai } Q^2 = 1 - [(1 - 0.004) \times (1 - 0.032) \times (1 - 0.01)] = 0.045$$

Value $Q^2 > 0$ means that this model is considered to have predictive relevance.

5. Conclusion

Auditor opinion is influenced only by the Firm Value. Although Firm Value is influence by corporate governance and earnings management, it is better for auditor to consider the extent of corporate governance practices and earnings management practices have an impact on the audited financial statement.

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