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THE EFFECT OF EARNINGS MANAGEMENT TO ISSUANCE OF AUDIT

QUALIFICATION: EVIDENCE FROM INDONESIA

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Abstract

Objectives: This paper examines whether the presence of earnings management trigger the level of issuance of qualified or modified audit opinion. The ultimate purpose of this research is to gain better understanding on the issuance level of qualified opinion and the reliability of audit opinion rendered by auditors in Indonesia.

Method: First, we estimated earnings management through cross-sectional modified Jones (Becker et al, 1998) model in our sample. Then, we performed a linear regression model (Johl et al, 2007) in order to analyze the relation between the earnings management measure and the independent and control variables influencing it. There are two hypotheses to be answered using this regression test results.

Results: For the first hypothesis results, there is a negative relationship between (ABDA) and (QUAL). This surprisingly means when the company practises (EM) it does not necessarily mean they are likely to receive qualified opinion from their auditors. For the second hypothesis results, there is a positive relationship between (ABDA*AQ) and (QUAL). This means when the company practices (EM) and being audited by the Big 4 and industry specialist auditors, they are likely to render a qualified opinion. However, the results for both hypotheses are insignificant due to extremely low evidence of only 4.76% companies with qualified opinion.

Conclusion: There is still low probability of issuance of audit qualification in Indonesia as indicated with only 4.76% of total 672 firm years from 2008-2010 receive audit qualification. We do not know whether the rest 95.24% (100% - 4.76%) truly deserve a clean unqualified audit report or perhaps the auditors have failed to detect earnings management practices within these audited companies.

Keywords

Earnings Management, Audit Qualification, Audit Opinion, Big 4 auditors, Indonesia