# CHAPTER I

# INTRODUCTION

## 1.1 Background

One important tool of communicating financial information to parties outside company is with the financial statements. In the Statement of Financial Accounting Concepts (SFAC) No. 1 states that the primary objective of financial statements is to provide information that useful in making business and economic decisions. Providing high quality information is important because it will positively affect capital providers and other stakeholders in making investment, credit, and other resource allocation decisions that will improve the overall efficiency of the market.

The separation of ownership and management of the company according to the agency theory potentially lead to conflicts between related parties, namely the agent and the principal. This conflict occurs because the principal and the agent have different interests. The management who have certain interests will tend to prepare financial statements in accordance with it's purpose not in the interest of the principal. This management behavior could certainly affect the quality of financial statements. Therefore, it needs the role of an independent auditor to give an opinion on the fairness of the company's financial statements consisting of balance sheet, income statement, statement of retained earnings, and cash flow statement. Thus, the expected capital providers and other stakeholders can make investment, credit, and other resource allocation decisions are more appropriately based on the information that has been audited by an independent party.

Statement of Auditing Standards No. 30 section 341 states that the auditor has responsibility to evaluate whether there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the financial statements being audited. Therefore, in addition to obtain information about the fairness of the financial statements presented by management, the independent auditor's report also provides information to users of financial statements about the company's ability to continue it's business. According to Arens, Elder and Beasley (2010), the financial statements are the responsibility of management to be audited by accounting firm as an independent third party. This is important because if it is not audited, it is likely that the financial statements contain errors either intentionally or unintentionally.



The trust from the interested parties is very important for the company to go public. Although this may be true, some people lost their trust in the auditor. There have been many legal cases involving business entities, especially in the accounting manipulation (Beams et. Al, 2013). These events have occurred in large American companies such as Enron, WorldCom, Xerox, and others that eventually went bankrupt. In that case, the public accounting profession being. This proves that the auditor has an important role in predicting corporate bankruptcies (Astuti and Darsono, 2012).

The bankruptcy of a large company or a financial institution often reveal many surprising things and leaving long polemic. The same thing happened with the case of the collapse of Lehman Brothers in the United States (US) September 15, 2008. Lehman Brothers is one of the largest investment bank in the US that more than 150 years. Lehman Brothers triggered a global financial crisis that led to the outflow of funds from banks stopped credit, trust of banks to companies fell sharply to create other big company went bankrupt too. The bankruptcy of Lehman Brothers even ultimately resulted in the practice manipulation of accounting standards (window dressing). Ernst & Young as the auditor independent at that time not fulfil the professional standards as auditors and conduct malpractice.

Going concern opinion that received by a company indicate the condition which raise doubts of auditor about the survival of the company. One of the considerations that need to be considered by the auditor to give a going concern opinion is to predict whether the company will be bankrupt or not. Gepp et al (2015) declared indication of future bankruptcy can be seen when companies run into financial distress. Financial distress is a condition where a company has difficulty paying off it's financial obligations to it's creditors. The chance of financial distress increases when a firm has high fixed costs, illiquid assets, or revenues that are sensitive to economic downturns. Basically, this will lead to financial distress so that the company's sustainability would be in doubt.

Audit tenure is the period of engagement that exists between public accounting firm with the same auditee (company). The issue of audit tenure is usually associated with the effect on auditor independence. Auditor's independence is fundamental to the reliability of auditor's report and has been adjudged as the cornerstone of the accounting profession and one of it's most precious assets (Odia, 2015). If the auditor ignores it's independence, the auditor will tend to be objective and be impartial to her clients.

Mutchler (1984) conducted interviews with practitioners auditor stating that the company received a going concern opinion in the previous year were more likely to receive the same opinion in the current year. It is also supported by research Carcello and Neal (2000), Lennox (2002), Januarti (2009), and Son (2010) who found a positive correlation between going concern audit opinion the previous year with the opinion of the current year. If in the previous year the company received a going concern audit opinion, then the current year the company will be more likely to receive a going concern audit opinion.



Many studies concerning factors that has proven effect on the going concern opinion. Which are Mutchler (1984), Geiger and Raghunandan (2002), Ross et al (2002), Haron et al. (2009), Beams et al (2013), Roberta et al (2015). Research in Indonesia on a going concern have been made by Dewayanto (2011), Kartika (2013) and Dwi cahyo (2014). Previous research studies prove different results about the factors that affect the acceptance of a going concern opinion.

Based on several studies that had been done previously by some researchers concluded that there were inconsistencies in the results of receiving going concern audit opinion. In the light of some research indicates that audit tenure has positive effect on receiving going concern audit opinion. For those inconsistency, the researcher interested in conducting further research on the effect of audit tenure and prior year audit opinion on going concern audit opinion.

## 1.2 Problem Definition

Based on research background above, the issue can be formulated as follows:

1. Does audit tenure influence Going concern audit opinion?

2. Does Prior Year Audit Opinion influence going concern audit opinion?

## 1.3. Research Objective

The purpose that writer want to reach by doing this research are:

1. To analyze and test the relationship of Audit tenure and Going Concern Audit Opinion
2. To analyze and test the Prior Year Audit Opinion Influence Going Concern Audit Opinion.

## 1.4. Writing Systematic

This paper is organized as follows. Chapter one explains the research background, problem definition, research objective, and writing systematic. Chapter two summarizes the theoretical framework, literature review on going concern audit opinion and hypothesis development. The research methods, which contain population and sample, variable identification and measurement, and data analysis method, is described in chapter three. Chapter four discusses the research analysis, and the research conclusion, limitations, and suggestions are presented in chapter five.