

Abstract

This study develops three models to predict a qualified audit opinion in the Indonesian financial market by incorporating corporate governance, audit, and financial characteristics. The hypotheses are built upon agency theory which suggests that board of director, external auditor, and financial information can be used as an effective device to monitor the credibility of financial reporting—proxied as qualified audit opinion. The argument in this study is that if qualified audit opinion is defined as a low quality of financial report, then a high quality of board of directors, external auditor, and financial information can be used to reduce the incidence of qualified audit opinion.

Using a sample of 732 companies listed in the Jakarta Stock Exchange (JSX) for the period 2002-2006, this study employs logistic analysis to predict the qualified audit opinion. Overall, the study shows the audit opinion can be predicted successfully with accuracy rate ranges from 83.4 percent to 84.5 percent for an estimation sample and holdout sample respectively. The variables that have significant predictive power are board of director size, board ownership, audit committee with more than three members, auditor report lag, leverage, liquidity, and industry type.

The logistic analysis results show a positive and significant relationship between ownership stake held by board of director's (supervisory board) members and qualified audit opinion. This result is contradictory to the traditional agency theory expectation which suggests that management ownership can be used to align conflict of interest between shareholders and managers. The

logistic analysis results confirm the entrenchment effect hypothesis that concentrated ownership in the hands of family members or individuals will shield the stockholder-controlled companies from monitoring by a board of directors (supervisory board). Nevertheless, the results support the agency theory expectation that members of a smaller board of director (supervisory board) perform better monitoring than larger boards. As expected in the hypothesis, the results show that where an audit committee comprises more than three members it is an effective device for monitoring the credibility of the financial report. The study provides evidence that incorporating corporate governance and audit characteristics in predicting a qualified audit opinion provides additional information that can not be elicited directly from financial statement information. Thus, the logistic models used by this study provide better accuracy rate in predicting a qualified audit opinion than studies incorporating only financial information into the models.

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List of Acronyms

ADB	:	Asian Development Bank
AICPA	:	American Institute of Certified Public Accountants
AusAID	:	Australian Agency for International Development
Bapepam	:	Badan Pengawas Pasar Modal (Capital Market Supervisory Agency)
BEI	:	Bursa Efek Indonesia (Indonesian Stock Exchange)
CEO	:	Chief Executive Office
CFO	:	Chief Financial Officer
GAAP	:	Generally Accepted Accounting Principles
IAI	:	Ikatan Akuntan Indonesia (Indonesian Accountant Association)
IAS	:	International Accounting Standard
IFAC	:	International Federation of Accountants
ICMD	:	Indonesian Capital Market Directory
JSX	:	Bursa Efek Jakarta (Jakarta Stock Exchange)
KLSE	:	Kuala Lumpur Stock Exchange
PSA	:	Pernyataan Standar Auditing (Statement on Auditing Standard)
PSAK	:	Pernyataan Standar Akuntansi Keuangan (Indonesian Financial Accounting Standard)
SA	:	Standar Auditing (Auditing Standards)
SPAP	:	Standar Profesi Akuntan Publik (Professional Standards for Public Accountants including Auditing Standards)