

Audit Opinion about Going-concern Uncertainty and Discretionary accruals in the Companies' Metal and Non-Metallic Minerals Industry listed Companies in Tehran Stock Exchange

Ali Khozein^{1*}, Ahmad Abdollahi², Fereshteh Daghigh²

¹*Department of Accounting, Aliabad Katoul Branch, Islamic Azad University, Aliabad Katoul, Iran*

²*Department of Management and Accounting, Golestan Institute of Higher Education, Gorgan, Iran*

* Corresponding Author Email: khozain@yahoo.com

Abstract: Since the external auditor influences the perceived quality of financial reporting, the audit opinion acts as a guardian of the management's behavior, especially when there is an increased tendency of earnings manipulation. From this optic, the audit opinion acts as a guardian of the management's behavior, especially when there is an increased tendency of earnings manipulation. In this paper, in order to examine the relationship between qualified audit opinion about going-concern uncertainty and discretionary accruals, and the main objective of this study determining the presence, amount and the kind of relationship between the mentioned variables which use actual and historical data of the companies' Metal and non-metallic minerals industry member of accepted companies in Tehran Stock Exchange in 2009 to 2013 is used. We divide the qualified audit opinions into two categories: qualified for the going-concern uncertainty and qualified for other reasons. The results indicate that audit opinions are not related to earnings management. The effect of audit qualified opinion about reasons except activity continuation with the discretionary accruals in metallic and non-metallic minerals industry is approved.

Keywords: Audit Opinion, Earnings Management, Discretionary Accruals, Tehran Stock Exchange.

Introduction

The external auditor plays a vital role in the corporate governance mosaic through its influence on promoting the quality of financial reporting. Since the external auditor influences the perceived quality of financial reporting, the audit opinion acts as a guardian of the management's behavior, especially when there is an increased tendency of earnings manipulation. The separateness of ownership from management provide this potential for managers to make decisions that are in line with their own interests and against the shareholder ones, conflict of interests which is interpreted as representation issue is the result of differences in the utility function of stakeholders. Considering the theory of conflicts between managers and owners interests one can argue that business managers may have the needed incentive to manipulate the benefits in order to maximize their benefits. On investigations on earning management, discretionary accruals meaning the items which management can manipulate the, have a great role. Accruals make difference between profit and cash flow, so supposing no manipulation occurs the only possible way is to manipulate the discretionary accruals. One of the affective ways in controlling discretionary accruals manipulation by manager which is the same as profit management is audit. This ways that a communication make a

bridge between audits findings with people inside and outside the company, are made as audit opinion that play an important role in alerting financial statements consumers about identifying problems that may encounter the company.

The main philosophy of audit is validating the reflected information in financial statements. Because, this information is the main basis of different groups decisions like shareholders, potential investors, brokers, managers, financial consultants, analysts, creditors and government. Therefore, from the point of view of users, especially shareholders, audit is beneficial when auditors spend time on assessing and analyzing the continuity of contact, the financial statements are free of error, fraud, illegal acts which are effective on the aimed company and announce their rate of success with respect to the mentioned tips. Considering the different result of past studies, two opposing viewpoints have been made. According to the first view, the companies which are encountering a crisis and their activity continuing is faced with ambiguity, may use earnings management to hide their status. In such a situation, the auditor chooses a conservative approach to minimize the risk of litigations and loss of reputation. The first group are more believed in increasing the level of auditor's conservativeness while encountering important ambiguity in the company's activity's continuity and mention that there is a direct relationship between reports on the subjects and discretionary accruals in such cases. In this approach, the main reason of reporting on the subject is considered to be uncertainty of activity's continuity not earning managements (lack of relationship between opinions and earning managements). In other words, according to this approach, some situations like activity continuation uncertainty increase the auditors' sensitivity and conservativeness due to increasing the auditors' risks. And in this kind of situations the probability of reports on the events is more than the cases that earning managements done and such a sensitive situation (not being sure of activity continuation) is not possible. According to the second approach, earnings management is the cause of reports on the cases (for any reason like ambiguity in the activity continuation or some other reasons). That is why, due to increasing discretionary accruals which are the result of manipulation in income items, is considered a cost, the probability of reports on the case increases and this case is not necessarily related with company's activity (Tsipouridou & Spathis, 2012). So, considering the importance of auditor's opinion and earning management in this study the relationship between the auditor's report on the issue and earning management is being analyzed. For this reason, in order to examine this relationship qualified audit opinion as independent variable and discretionary accruals as dependent variable is used, and the main objective of this study determining the presence, amount and the kind of relationship between the mentioned variables which use actual and historical data of the companies' Metal and non-metallic minerals industry member companies of Tehran Stock Exchange is used.

Literature review and hypotheses

Our study revisits the potential link between earnings management and the likelihood of receiving a qualified opinion. Prior studies, mostly from the US, provide mixed evidence on the nature of this relationship. Francis and Krishnan (1999), using a large sample of US listed firms and after controlling for client-specific financial and market risk variables, find that auditors of firms with high levels of accruals in absolute terms are more likely to issue qualified opinions for asset realization uncertainties and for going-concern problems, than auditors of firms with low absolute levels of accruals. These relationships stronger for firms with large negative accruals. Similarly, Bartov et al (2001), in a study examining the ability of various accruals models to detect earnings management, find that a significant positive link exists between the absolute value of discretionary accruals and the likelihood of receiving a qualified opinion. However, this relationship is significant for only two of the models tested – the cross-sectional Jones (1991) model and the cross-sectional modified Jones (Dechow et al., 1995) model. By contrast; Bradshaw et al (2001) find no evidence that the frequency of qualified audit opinions is higher in firms with sizeable accruals. They conclude that auditors do not alert investors to the increased incidence of future earnings declines and GAAP violations that are often associated with high levels of accruals on a timely basis. The rationale is that such earnings quality issues are beyond the scope of the audit. In other words, auditors may understand that inflated accruals imply a greater likelihood of future earnings declines and GAAP violations, but they are not required to communicate this information to investors through their audit opinions. Butler et al (2004) support this view and conclude that auditors are unlikely to issue qualified opinions for earnings-management reasons. More specifically, based on over 7000 qualified opinions of US firms for the period 1994–1999, they examine the relationship between abnormal accruals and audit opinion type. They find a positive association between modified opinions and abnormal accruals, when accruals are measured in absolute terms. When they change the dependent variable from the absolute level to the actual amount of abnormal accruals, they discover that qualified opinions are negatively related to accruals. They attribute this negative association to the fact that firms with large negative accruals tend to receive GC opinions, which are motivated more by their distressed status and not by earnings management. Overall, they

find no evidence that auditors use the audit opinions to alert financial statement users of either excessive earnings management or the consequences of high levels of positive accruals. The above studies are conducted in the US. Few investigations from countries with different institutional settings and auditor reporting regimes have investigated this issue. Herbohn and Ragunathan (2008) investigate whether a negative association exists between actual abnormal accruals and the probability of receiving a qualified audit opinion in Australia. They focus on a sample of firms listed on the Australian Stock Exchange over the period 1999–2003. Consistent with Butler et al (2004), they document a negative link between the likelihood of a qualified opinion and accruals that is driven by going-concern issues for firms with a greater risk of financial distress and audit litigation. Their results suggest that earnings management is not the cause of audit opinion qualifications. Arnedo et al (2008) test this relationship in a Spanish context for a sample of private pre-bankrupt firms. They separate the qualified opinions into two groups – qualified based on going-concern issues and qualified for other reasons. Their evidence, consistent with Butler et al. (2004), reveals a negative association, which stems from reports containing uncertainty about the likelihood of a firm continuing as a going-concern. A positive relationship is found, however, when the reasons for the qualification are other than the going-concern. Unlike Butler et al (2004), they claim that auditor reporting is a positive response to earnings management and that the negative relationship in going-concern cases is a consequence of auditor conservatism rather than a result of the distressed status of the firm and its liquidity tactics for survival. The inconclusive evidence of prior studies raises a question regarding the association between earnings management and the issuance of a qualified audit opinion in Greece. In contrast to the US, where most audit reports are qualified based on the going-concern uncertainty, Greek qualified audit reports are frequently issued for reasons other than going-concern. This implies that auditors have the opportunity to convey different warning signals to users of the financial statements. In an effort to examine this relationship in detail, we divide qualified opinions into two categories– qualified based on the going-concern uncertainty and qualified for reasons other than the going-concern uncertainty. Our hypotheses, stated in the null form, are as follows:
Hypothesis: Qualified audit opinions for reasons other than the going-concern uncertainty are not associated with discretionary accruals, other things being equal.

Materials and Methods

The present study is practical in term of objective and descriptive and correlational considering nature and method. Also in terms of time is after the events type. Moreover, this is a correlational one in term of nature and method. This study is regression (after the event) in term of study nature. In the present study, the needed data about company members of metallic and non-metallic industry during the year 2009 to 2013 have been collected by electronic archives of Tehran exchange market and financial information cds of the accepted companies. In order to analyze data and test the hypothesis, multiple regression analysis and Pearson correlation are used, this means that first needed information to perform the calculation mode and then regression tests are done to explore the relationship between audit opinions and earning management (discretionary accruals) in the metallic and non-metallic industry. Also, Excel and EVEIWS soft wares are used to analyze the information and statistical tests. In order to examine the statistical hypothesis, first derived regression model accuracy is analyzed and then using T and F tests the amount of effect of independent variable on the dependent variable as tested.

Results

Table 1. The results of regression model analysis.

$NGC_{it} = \beta_0 + \beta_1 DA_{it} + \beta_2 TURN_{it} + \beta_3 INVREC_{it} + \beta_4 TLE_{it} + \beta_5 ROA_{it} + \varepsilon_{it}$					
Dependent variable: audit opinion on reasons other than non-going concern (NGC)					
Independent variable	Symbol	Ratio	Z statistics	Significant level	Result
Intercept	β_0	1.079130	1.688822	0.0913	-
Earning management	DA	0.219800	2.623913	0.0332	Approved
Ratio of total sales to total asset	$TURN$	-5.021298	-4.202414	0.0000	Approved
Ratio of inventory, accounts and received notes to total asset	$INVERC$	4.247207	2.418275	0.0006	Approved
Ratio of total debt to total salary of shareholders	TLE	0.426231	1.676154	0.0937	Rejected

Assets output	<i>ROA</i>	0.4787	0.708387	1.842957	Rejected
McFan determination coefficient		0.193551	LR statistics(significant level)		51.50094 (0.000070)

As shown in follow table the McFan coefficient of determination is 0.19355 and the value of statistic LR is 51.50094 and the probability statistics of LR is 0.0000, and since its possibility is less than 0.05 the model significance is approved. The results of Hasmer- Lamsho and also the percentage of correct prediction are given in below table, given the fact that the correctness of prediction value for 1 and 0 (dependent variables) are relatively high and also the percentage of total correct prediction is 75.62, so the utility of the model is approved. On the other hand, the value of Hasmer-Lamsho statistic and Androz is more than 0.05 and as the result null hypothesis is accepted and the model the model ideal explaining capability is approved.

Table 2. Hasmer-Lamsho test and Accuracy prediction percentage.

Hasmer-Lamsho test		Accuracy prediction percentage	
Androz statistics(possibility amount)	Hasmer-Lamsho statistics(H_L) (possibility amount)	76.60	Dep=0
		74.49	Dep=1
Total	75.52	15.6733 (0.1094)	12.5326 (0.1290)

According to the results of follow table, the coefficient value, Z statistic and the significance level for the second hypothesis are respectively 0.219800, 2.623913 and 0.033. Since the significant level is less than 0/05 so the null hypothesis is rejected and the alternative hypothesis about the effect of audit qualified opinion about reasons except activity continuation with the discretionary accruals in metallic and non-metallic minerals industry is approved (the acceptance of hypothesis).

Conclusion

In this paper, in order to examine the relationship between qualified audit opinion about going-concern uncertainty and discretionary accruals, and the main objective of this study determining the presence, amount and the kind of relationship between the mentioned variables which use actual and historical data of the companies' Metal and non-metallic minerals industry member of accepted companies in Tehran Stock Exchange in 2009 to 2013 is used. The hypothesis states that the audit qualified opinions have a significant effect on the reasons except activity continuation, with discretionary accruals in metallic and non-metallic mineral industry. The results of the study suggests that the second hypothesis is confirmed and given (0.219800) as the positive coefficient value, it can be said that the higher the absolute value of clients discretionary accruals, the more auditor report for reasons other than activity continuation is issued in qualified way. And the less discretionary accruals are, the less will be the possibility of receiving auditor's qualified report on reasons other than company's activity continuation. Thus, the second hypothesis in the study is approved, and it means that if there is no certainty in the activity continuation, the auditors will be more sensitive to discretionary accruals and this will lead to have more motivation to modify his report. The reason of this opinion can be justified in the way that in this case the, the auditor is in the natural risk of reasons other than activity continuation, litigation, and etc. In fact, these findings show that auditors is sensitive to discretionary accruals and in the cases which a significant uncertainty about reasons other than company's activity's continuation is faced, the possibility of issuing qualified opinion is more and thus the auditors will be more conservative. Accordingly, the auditors has a higher motivation to report in a qualified opinion and this way he tries to transfer the client company's earning managements information to the financial statements users. These findings are in contrast with researchers like Batler et al (2004) and Tsipouridou and Spathis (2012).

Conflict of interest

The authors declare no conflict of interest

References

Arnedo L, Lizarraga F, Sanchez S, 2008. Discretionary accruals and auditor behavior in code-law contexts: An application to failing Spanish firms. *European Accounting Review*. 17(4): 641–666.

- Bartov E, Gul FA, Tsui JSL, 2001. Discretionary-accruals models and audit qualifications. *Journal of Accounting and Economics*. 30(3): 421–452.
- Bradshaw MT, Richardson SA, Sloan RG, 2001. Do analysts and auditors use information in accruals?. *Journal of Accounting Research*. 39(1): 45–74.
- Butler M, Leone AJ, Willenborg M, 2004. An empirical analysis of auditor reporting and its association with abnormal accruals. *Journal of Accounting and Economics*. 37(2): 139–165.
- Dechow PM, Sloan RG, Sweeney AP, 1995. Detecting earnings management. *Accounting Review*. 70(2): 193–225.
- Francis JR, Krishnan J, 1999. Accounting accruals and auditor reporting conservatism. *Contemporary Accounting Research*. 16(1): 135–165.
- Herbohn K, Rangunathan V, 2008. Auditor reporting and earnings management: Some additional evidence. *Accounting and Finance*. 48: 575–601.
- Jones J, 1991. Earnings management during import relief investigations. *Journal of Accounting Research*. 29(2): 193–228.
- Tsipouridou M, Spathis C, 2012. Earnings management and the role of auditors in an unusual IFRS context: The case of Greece. *Journal of International Accounting, Auditing and Taxation*. 21(1): 62–78.