

THE INTERDEPENDENCE BETWEEN THE TYPE OF AUDIT OPINION AND THE VARIATION OF THE STOCK PRICE

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Abstract: : In a modern financial market, potential investors are constantly looking for high-yield and low-risk financial investments. Undoubtedly, the audit of financial statements is one of the processes that lead to minimizing the risk of financial loss, following a decision to invest in a particular company. It has already become normal for audit reports to include in addition to financial and non-financial information that could have an impact on the company's business in the future. The main objective of the study is to identify the impact of issuing audit reports on the value of shares of Romanian public companies. The paper evaluates the reaction of the Romanian stock market to the events of publishing audit reports that contain different types of audit opinions. The practical significance and relevance of the paper is due to the growing role of auditing on the financial market and the lack of such papers in the national literature.

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1. INTRODUCTION

The development of an economy requires the active attraction of market capital in the industrial and banking sectors. Capital market investors will be constantly interested in truthful, reliable and comparable information provided by companies. They may obtain such information primarily from the audited financial statements. Therefore, with the development of the capital market, the responsibility of auditors towards investors and other external users of the financial statements of the organization increases with the expression of an independent opinion on the reliability of the financial statements.

The main role of today's independent auditor is to provide reasonable assurance on the preparation of financial statements in accordance with accounting regulations. The audit has already become part of the capital market, as it not only helps to reduce the costs of exchanging information between the company and stakeholders, but also provides a market signaling mechanism for the veracity of information provided by the audited entity. The auditor provides an independent audit of a company's financial statements and, as a result, the audit loses its value when such independence as to give credibility to the financial statements is undermined.

In a modern financial market, potential investors are constantly looking for high-yield and low-risk financial investments. Undoubtedly, the audit of financial statements is one of the indicators that reduces the risk of a financial loss, following a decision to invest in a particular company. At present, the submission of "binary" audit reports, including the opinion whether "the verification has passed or the verification has failed", cannot fully meet the information requirements for shareholders and investors. It has already become normal for audit reports to include in addition to financial information and non-financial information that could have an impact on the company's business in the future. There is a change in the attitude of users of financial information: it is no longer considered unusual for auditors to report more information than required by law.

2. OBJECTIVES

The main objective of the study is to identify the impact of issuing audit reports on the value of shares of Romanian public companies. The paper evaluates the reaction of the Romanian stock market to the events of publishing audit reports that contain different types of audit opinions. The practical significance and relevance of the paper is due to the growing role of audit in the financial market and the lack of such papers in the internal scientific literature.

3. DEVELOPMENT OF RESEARCH HYPOTHESES

In the process of globalization, the expansion of economic relations, increasing competitiveness and technological progress of economic entities, has influenced the audit report to be an area of interest for many researchers. However, to date, "the conclusions provided by the studies that have been undertaken in the field of audit reporting have been contradictory and inconsistent."¹

For the same purpose, researcher Roberston JC investigated whether the type of audit opinion influences the investment strategy of financial analysts. To do this, he sent an identical set of financial statements of a hypothetical company to the respondents and each set to have a type of audit opinion. Participants in this study were asked to answer three questions: "1. If they felt that the audit report added credibility to the financial statements; 2. If it would be based on this information when making financial investment decisions; 3. Whether the audit report can meet the information

¹ Craswell, A. (2015). Studies of information content of qualified audit reports. *Journal of Business, Finance and Accounting*, 12(1), 93-116.

needs for the investment process." ² The results indicated that financial analysts did not make significant distinctions among the different types of audit report qualifications.

² Robertson, J. (1988). Analysts' reactions to auditors' messages in qualified reports. New York: Accounting Horizons.

Since 1970, the research conducted by economist Firth M. entitled "Qualified audit reports: their impact on investment decisions" has begun to study the impact of audit reports on share price and capitalization of companies listed on the US stock exchange. Therefore, the researcher concluded that: "The share price may vary depending on the type of opinion and the type of qualification influences both the investment strategy and the decisions of investors."³

From the perspective of a capital market investor, the issuance of an audit opinion with reservation or the impossibility of expressing the opinion for the company in which it holds shares / bonds, is an alarm signal that requires the reorientation of the financial investment to other entities. Starting from this theory, the economist Dodd P, focused on researching only the impact of qualified opinions on prices per share. "Their results indicated that many companies experienced abnormal negative performance and that the extent of abnormal performance differs depending on the types of qualifications. In addition, there was little evidence of an effect on the share price when the qualifications were not publicly disclosed."⁴ In other words, if a country's legislation does not require the company to publish the audit report, the auditor's opinion will have little impact on the price per share.

The subject of the analysis of the influence of the audit opinion on the share price, at present, is quite discussed and provokes contradictory opinions in the scientific world. These problems would be generated primarily by the level of market development, the degree of financial education of potential investors but also the specificity of the microeconomic specificity of a specific country. Thus, a large number of studies conducted by Dopuch & Holthausen⁵, Chen C.⁶, and Menon & Williams⁷ provide sufficient evidence that "the share price decreases significantly after the publication of the audit report with a modified opinion in compared to one without reservations. " For example, economist Chen, in his 2000 study, examines the stock trend of companies listed on the Shanghai Stock Exchange in response to a positive or changed audit opinion. He concludes that the amended opinion undoubtedly causes a decrease in the value of the shares and the company.

Researcher Lin used an experimental study to investigate users' responses to the audit opinion issued to Chinese companies. Investors as well as potential bank creditors were asked whether their decisions were affected by the financial statements accompanied by qualified or unqualified audit opinions. The results of the study showed that "the modified audit opinion negatively affected the decisions of investors

³ Firth, M. (1978). Qualified audit reports: their impact on investment decisions. Chicago: The Accounting Review.

⁴ Dodd, P. (1984). Qualified audit opinions and stock prices: information content, announcement dates, and concurrent disclosures. 6(1), 3-38.

⁵ Dopuch, N., & Holthausen, R. (1986). Abnormal stock returns associated with media. Journal of Accounting and Economics., 93-117.

⁶ Chen, C. (2000). An emerging market's reaction to initial modified audit opinions: evidence from the Shanghai Stock Exchange. Contemporary Accounting Research, 429-455.

⁷ Menon, K., & Williams, D. (2010). Investor Reaction to Going Concern Audit Reports. San Diego: Accounting.

and creditors, without any significant differences between the opinions of these groups of information users." ⁸

On the other hand, there are a large number of researchers such as Martinez & Benau⁹ and Ogneva & Subramanyam¹⁰, who do not support the hypothesis that the type of audit opinion provided has a significant role in investment decisions. Analyzing the evolution of stock market prices in relation to any type of audit opinion, this group of researchers found that there is no relationship between these two variables.

Starting from the information identified in the literature, I set out to test the following research hypotheses for the Romanian capital market:

- The existence of a correlation between the audit opinion and the volatility of the share price;
- Existence of a change in share price specific to the type of audit opinion issued.

4. DATA AND SAMPLE

Therefore, a sample of 39 companies was used to conduct this study, listed on the Bucharest Stock Exchange, of which 19 companies from Int & Premium category and other 20 companies from Standard category. The financial information was collected from the BVB website and covers a time interval of 4 financial years (2017-2020). Thus, the structure by fields of activity of the sample of audited companies for the analyzed time period is presented in table no.1. There is a significant share of entities in the industry, financial, energy, medical and materials sectors representing 70% of the total number of companies analyzed.

Table no. 1 The structure of the sample of companies by fields of activity

| Economic sector | No.of companies | % share |
|------------------------|------------------------|----------------|
| Industry | 9 | 23% |
| Financial | 8 | 21% |
| Energy | 4 | 10% |
| Medical | 3 | 8% |
| Materials | 3 | 8% |
| Production | 3 | 8% |
| Goods | 2 | 5% |
| Services | 2 | 5% |
| Construction | 2 | 5% |
| Utilities | 1 | 3% |

⁸ Lin, Z. (2003). An experimental study of users responses to qualified audit reports in China. *Journal of International Accounting, Auditing and Taxation*, 1-22.

⁹ Martinez, A., & Benau, M. (2004). Reactions of the Spanish capital market to qualified audit. *Barcelona: European Accounting Review*.

¹⁰ Ogneva, M., & Subramanyam, K. (2004). Does the stock market under-react to going concern opinions? *Journal of Accounting and Economics*, 439-452.

| | | |
|--------------|-----------|-------------|
| IT | 1 | 3% |
| Tourism | 1 | 3% |
| TOTAL | 39 | 100% |

5. AUDIT OPINION AND PRICE PER SHARE

In the first stage of the research study, the number of types of opinions was analyzed, over a period of four consecutive financial years, related to each sector of activity of which the company is part. According to table no. 2, there is a significant share of 84% of the type of audit opinion “Without reservations” from the total number of opinions issued. Therefore, most of the positive opinions were allocated to the financial and industry sectors. For the financial sector, the existence of a 94% share of the confirmation of the financial statements with the accounting regulatory framework¹¹, compared to the 61% industry sector, can be explained by double control by both audit entities and state regulatory institutions such as would be: the Romanian National Bank and the Financial Supervisory Authority.

Table no. 2 Synthetic situation of the types of audit opinion by sector of activity

| Economic Sector | No.of companies | Unqualified opinion | Qualified Opinion | Adverse Opinion | Disclaimer of Opinion |
|-----------------|-----------------|---------------------|-------------------|-----------------|-----------------------|
| Goods | 2 | 8 | 0 | 0 | 0 |
| Financial | 8 | 30 | 1 | 0 | 1 |
| Services | 2 | 8 | 0 | 0 | 0 |
| Utilities | 1 | 4 | 0 | 0 | 0 |
| Energy | 4 | 12 | 4 | 0 | 0 |
| Medical | 3 | 12 | 0 | 0 | 0 |
| Materials | 3 | 10 | 2 | 0 | 0 |
| Construction | 2 | 8 | 0 | 0 | 0 |
| Industry | 9 | 22 | 8 | 2 | 4 |
| IT | 1 | 4 | 0 | 0 | 0 |
| Production | 3 | 10 | 2 | 0 | 0 |
| Tourism | 1 | 3 | 1 | 0 | 0 |
| Total | 39 | 131 | 18 | 2 | 5 |

If up to this point we have presented the distribution of types of opinion by activity sectors, from now on we have analyzed the impact of the audit opinions issued on the volatility of the share price. For each year, the type of auditor's opinion was

¹¹ The degree of compliance of the financial statements with the accounting regulatory framework has been calculated as a share of the number of unqualified opinions in the total number of audit opinions issued for a given sector.

correlated with the change in the price of a share at the date of publication of the financial statements, as the difference between the opening price and the closing price. The research based on audit reports and trading prices, taken from the public database of the nationally regulated stock market, the Bucharest Stock Exchange, presents the following annual correlations, between the type of opinion issued by the independent financial auditor and price volatility. per share, according to table number 3:

Table no. 3 Number of correlations between audit opinion type and share price volatility

| Type of opinion | Positive evolution | | | | Negative evolution | | | | No changes | | | |
|------------------------------|--------------------|-----------|-----------|-----------|--------------------|----------|----------|-----------|------------|----------|----------|----------|
| | 2017 | 2018 | 2019 | 2020 | 2017 | 2018 | 2019 | 2020 | 2017 | 2018 | 2019 | 2020 |
| <i>Unqualified opinion</i> | 18 | 20 | 26 | 17 | 3 | 6 | 3 | 9 | 11 | 8 | 4 | 6 |
| <i>Qualified Opinion</i> | 3 | 3 | 1 | 2 | 3 | 0 | 1 | 2 | 0 | 0 | 2 | 1 |
| <i>Adverse Opinion</i> | 0 | 0 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| <i>Disclaimer of Opinion</i> | 0 | 0 | 0 | 0 | 0 | 2 | 1 | 1 | 1 | 0 | 0 | 0 |
| Total | 21 | 23 | 27 | 19 | 6 | 8 | 6 | 12 | 12 | 8 | 6 | 8 |

It can be seen that most companies listed on the stock market have financial statements that provide a true and fair view of their financial position and performance. Therefore, the justification for the high degree of compliance identified in the regulated market is based both on the level of responsibility for the large number of attracted investors and on additional quality criteria on the financial reporting process imposed by the BVB supervisory body, such as would be: "implementation of the Corporate Governance Code, introduction of the corporate governance index and implementation of Sustainability Reports."¹²

Based on the information presented above, we can deduce the probability with which a type of opinion influenced the relative change in the price of a share at the time of publication of the audit report, probability found in table number 4:

Table no. 4 Impact of the type of audit opinion on the evolution of the share price

| Opinions | % Positive evolution | % Negative evolution | % No changes |
|------------------------------|----------------------|----------------------|--------------|
| <i>Unqualified Opinion</i> | 62% | 16% | 22% |
| <i>Qualified Opinion</i> | 50% | 33% | 17% |
| <i>Adverse Opinion</i> | 0% | 50% | 50% |
| <i>Disclaimer of Opinion</i> | 0% | 80% | 20% |

¹² BVB. (2021). Sustainable Stock Exchanges. Retrieved from <https://www.bvb.ro/AboutUs/UNSSEinitiative>

At the level of the analyzed sample, the unqualified opinion issued by an independent financial auditor, influenced in a proportion of 62% the positive trend of the share price. Both the negative evolution and the non-modification of the price related to this type of opinion are explained by the registration of negative variations of the main economic-financial indicators and of the conservative character, regarding the investors, which is strongly influenced by the microeconomic and macroeconomic environment.

In the case of a qualified opinion, there was a positive evolution in a proportion of 50% of the share price, determined by the strategy of the “aggressive” type investor who assumed a possible loss predicting a future increase of the financial results presented by to the company. The compliance of the “conservative” type investor with the material errors identified by the financial auditors, at the level of the financial statements, led to the modification of the investment plan, by withdrawing the capital at a negotiated price lower than the previous audit opinion.

The opposite opinion and the impossibility of expressing an opinion, in most cases, have a negative impact on the evolution of the share price, due to a lack of presentation and provision of transparent information for the decision-making process of current and potential investors.

6. CONCLUSIONS

The analysis of the information and data presented in the study allowed us to formulate the following conclusions:

- The level of “ unqualified” opinions did not change significantly during the financial years analyzed (2017-2020). This type of opinion represents 84% of the total audit opinions issued for the 39 entities listed on the Bucharest Stock Exchange, during the four analyzed periods;
- At the level of the analyzed sample, there is a close correlation between the type of audit opinion and the volatility of the share price, being identified three levels of its evolution: positive, negative and without changes;
- The significant influences identified at the level of each of the four types of audit opinions are presented according to table number 5:

Table no. 5 Significant influences identified at the level of each of the four types of audit opinions

| Opinions | Type of evolution of price |
|------------------------------|-----------------------------------|
| <i>Unqualified opinion</i> | Positive |
| <i>Qualified Opinion</i> | Positive |
| <i>Adverse Opinion</i> | Negative |
| <i>Disclaimer of Opinion</i> | Negative |

- The unqualified opinion influences, in most cases, the positive evolution of the transaction price;

- The impact of a qualified opinion on the share price follows the trend generated by the unqualified opinion, justified by the positive variation of financial indicators;
- The contrary opinion and the impossibility of expressing an opinion, considered unfavorable by investors, presented to a large extent a negative evolution of the trading price.

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