



“The reaction of the financial market on the auditor report: an empirical study on service companies listed in Amman Stock Exchange (ASE)”

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# THE REACTION OF THE FINANCIAL MARKET ON THE AUDITOR REPORT: AN EMPIRICAL STUDY ON SERVICE COMPANIES LISTED IN AMMAN STOCK EXCHANGE (ASE)

## Abstract

Auditing has a very important role in the economic life and the auditor's report is considered as the end of accounting information system in the enterprise, where it gives full and thorough summary of information content. So, this study aims to identify the existence level and form of financial market reaction on the auditor report by defining the change impact of the external auditor's opinion on the stock prices of service companies listed in Amman Stock Exchange (ASE) in the period 2010–2017. The study population consists of all the 37 service companies listed in ASE, in which the audit report type has changed from unqualified to qualified and vice versa, where the number of observations was 48 – 32 from unqualified to qualified and 16 from qualified to unqualified. The results showed that there is statistically significant difference of stock prices after changing the report type from unqualified to qualified, where its prices declined as a result of this change, while there weren't any statistical differences of stock prices as a result of changing the report type from qualified to unqualified. So, companies must pay more attention to the auditor report issued on its behalf, and work at its best to keep this report unqualified.

## Keywords

auditor report, financial market reaction, stock prices, Amman Stock Exchange (ASE)

## JEL Classification

M40

## INTRODUCTION

The auditing profession arose from the need to credible financial data and statements, which are appropriate to make decisions, and improved over time to become one of the mandatory legal requirements in most of the world countries, where the Jordanian companies act in its article 141 required the public shareholding companies to prepare and publish an annual financial statements, which are reinforced by the external auditor report within three months from the end of the financial year of the company.

The existence of agency theory, which arose from the separation of management and property and the problems caused by it, gave the owners and shareholders a strong motivation to have an independent party, which gives them assurance about the information provided by managers to rely on it for making investment decisions.

Mainly, the importance of financial statements derives from its role in providing decision makers with the needed data to make right and rational decisions, and this importance of financial statements made it the center of attention of most categories related to the company. This will increase the importance of auditing, which aims to express the opinion in these statements through the auditor opinion

that will be issued at the end of the auditing process, where its results influence the quality of financial statements presentation, and therefore lead to reduce the data cost and increase the confidence in the published data.

The market reaction and the response of market leaders to the auditor report stayed relatively slow due to the non-spreading of awareness and knowledge about the role and significance of auditor report. However, it's not possible to overlook the role of auditor report on influencing the companies, which can be seen and noticed through the interest level of those companies about the type of issued report related to it, and its strive for this report to be good and unqualified.

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## 1. LITERATURE REVIEW

### 1.1. Previous studies

Many of the previous studies were concerned with the nature of market reaction toward many of the financial and accounting data, and after that many studies had examined the impact of financial statements information on the stock prices and its market returns, nevertheless, the studies that addressed the information content topic of auditor report and its impact in making the investment decision was relatively low, especially the Arabic studies.

At first, the study of Saidah (1998) came to investigate the impact of external auditor qualification of the share price and the return on company's shares in the financial market, where the final study sample consisted of 19 companies that received qualified opinions, during the period 1991–1994 at ASE. The results showed that stock prices and market revenues are negatively influenced during the period surrounding the issuance of qualified report, and it has showed that launching the auditor qualification at the same time of declaring the result of the company's business didn't confuse the investors at the market, and even with the majority of the sample companies announcing profits in their audited financial statements, the negative impact of auditor qualification on these statements was clear.

The study of Thuneibat et al. (2007) aimed to examine the impact of qualified audit report on the stock prices and dividends in Jordan, where the study focused on the Jordanian shareholding companies, which got a qualified report for the period 2002–2005. The results showed no apparent effect of qualified report on the stock prices and dividends in the Jordanian companies.

The study of Tahinakis et al. (2010) came out to examine the effect of issuing the qualified report on corporate share prices at Athens stock exchange, for the period 2005–2007, where the market model was used to examine the effect of issuing the qualified report on stock prices. Therefore, this will tell us about the information content level of auditor's report for users of financial statements. The results of study showed the information content limitation of auditor's report, where the auditor's report didn't form as a part of the investment decision making process for investors, and also the study didn't find any effect of auditor's report on stock prices at Athens stock exchange.

Zurikat's (2010) study aimed to test the impact of modified auditors' opinions on the company's share prices, which received these opinions during the period 2002–2007, where the study sample consisted of 53 Jordanian public shareholding companies listed at ASE. The study results reached to the existence of statistically significant impact for the modified auditors' opinions on the company's share prices, depending on the event study method. The researcher also found a significant impact of qualified reports on stock prices, which led to lowered share prices of companies that received these opinions, and as a result negative extraordinary returns around the date of publishing these views or opinions.

The study of Hsu et al. (2011) came to investigate the behavior of stock prices at the shareholding companies of Taiwan at the time of issuing a qualified report. A sample study of 106 public shareholding Taiwanese companies was used during the period 1999–2009, and the results showed the existence of unusual negative returns over 5 days following the issuance of qualified report, which indicate the significant impact of auditor's report on the investors and their decisions.

The study of Ittonen (2012) examines the market reaction on the qualified report by reviewing the previous literatures and studies that dealt with this topic during the period 1972–2010, and its important results were summarized, where it enclosed the used methods by previous studies to measure the market reaction on the auditor's report. The study found big discrepancies in the results of previous studies due to the diversity of used methods, which become difficult to select and specify a single result.

The study of Lanniello and Galloppo (2015) came to test the investors' reaction on the qualified or unqualified reports, which contain a paragraph about the company investment in Italy. Study collected special data from the financial statements, and came up with the conclusion that auditor's report is considered an informative material for the investment decisions. It also found that qualification of auditor's report had a negative impact on stock prices, while the unqualified report had a positive impact on stock prices, with a paragraph about the continuity of the company.

The study of Mustikarini and Samudera (2017) also came to identify the reaction of investors toward an issued qualified report at the Indonesian market, whereas this report gives an indication that something is wrong and must be focused on it. Market reaction was measured by two variables: unnatural dividends or stock returns, and volume of stock trading and a study sample of 56 companies listed at the Indonesian stock exchange were taken for the period 2010–2015. Results showed a relatively significant market reaction on the auditor's qualification, when using the stock trading volume as a dependent variable, but it didn't show any market reaction when using the abnormal returns of stocks as a dependent variable.

Finally, the study of Danescu and Spatacean (2018) came in order to measure the impact of auditor report on the financial assets prices by focusing on the impact of auditor qualified report on the movement of stock prices, where it selected 32 shareholding companies at Bucharest stock exchange and observe the movement of its share prices, for the period 2009–2017, with the focus on price movements at the time of issuing a qualified report. The study didn't find any obvious impact of qualified auditor report on the stock prices.

## 1.2. What distinguishes this study from other researches

This study came to measure the financial market reaction on the various types of auditor's report, and wasn't restricted to a certain type, where this study differentiated from its predecessors by studying the impact of qualified reports, in addition to the unqualified reports. The unqualified reports must be taken care of, especially when it comes after a qualified report due to cleaning of qualified report considers undeniable big effort that must be discussed, and identify its impact on the financial market and on investors' decisions.

This study also characterized by including the services sector at ASE, which requires various studies due to the lack of scientific researches and research studies about this sector in Jordan, especially that the services sector is one of the largest sectors, as it has the largest number of companies compared to other sectors.

## 1.3. Study hypotheses

This research came out to test the following two main hypotheses:

*H1: There aren't any statistically significant differences of the average of stock prices after changing the auditor report type from unqualified to qualified and the average prices before the change.*

*H2: There aren't any statistically significant differences of average of the stock prices after changing the auditor report type from qualified to unqualified and the average prices before the change.*

## 2. STUDY AIMS

The efficiency of investment decisions depends on the validity and accuracy of information provided to investors, where the audit is considered one of the most reasonable means to ensure that companies have submitted the accurate information; which means that auditor report that attached to the financial statements is considered extremely

important for investors and their decisions, therefore, it's a must to identify the significant level of this report on affecting the decisions of investors.

This research came out to study the market reaction on the auditor report type by studying and identifying the possible relationship between the issued report type of the company and the price of its market share through comparing prices of shares before the auditor change of report type and the prices after the change. Two types of auditor reports were taken, which are unqualified report and qualified report, due to the absence of any negative report or the expression of any opinion on the financial market.

So, this study aims to identify to what extent does the auditor opinion impact on market share prices at ASE, taking into consideration the type and form of this opinion whether it was unqualified or qualified, and therefore the study aims to:

- detect the existence level of auditor report type change cases in the service companies listed at ASE;
- identify the impact of change of auditor report type from unqualified to qualified on the share prices of service companies listed at ASE;
- identify the impact of change of auditor report type from qualified to unqualified on the share prices of service companies listed at ASE.

### 3. THEORETICAL FRAMEWORK

#### 3.1. Auditing and its importance

Auditing plays an important role in the economical life and the auditor's report is considered as the end of accounting information system in the enterprise, where it gives full summary of information content, which confirms the enterprise activity through particular period of time.

Auditing was defined by the American Accounting Association (AAA) as a systematic and methodi-

cal process for collecting and evaluating evidences, contexts, and clues objectively, which are related to the results of activities and economical events, in order to determine the compatibility level between these results and the specified standard, and then deliver the auditing results to the beneficiaries, where the International Auditing Standards Board (IASB) defined it as a process where the participant shows a conclusion designed to raise the confidence of intended users about the information provided to them (Jumu'ah, 2009).

Whereas, Matarneh (2009) defined it as a systematic process for obtaining the evidences and clues associated with the elements of economical events, and evaluate it objectively to ensure the compatibility degree between these elements and the preset standards, and then deliver the results to the interested parties.

In recent years, the demand for audit services has increased because of several factors like the sudden collapses of powerful companies, where Arens et al. (2012) summarized the factors for increasing the demand on auditing services by three factors: the distance gap between the financial statements users and the persons who prepare these statements, increased complexity degree of economical events, and the expected impact of financial statements on the decision making process.

Arens et al. (2012) divided the auditing objectives into two main objectives:

- obtain a reasonable assurance that the financial reports as a whole, free of substantial errors, which enable the auditor to express an opinion about whether the financial statements, were prepared in all substantial respects in accordance with the applicable setup framework;
- auditor will submit a written report in accordance with the applicable auditing standards that include the auditor technical opinion about the fairness of the financial statements as a whole.

The importance of auditing for various parties returned to being a means, but not an end. This means is designed to serve the multiple parties that use the audited financial statements, and depend

on it in making the decisions, the most important of these parties are: employees, current and potential investors, lenders and creditors, clients, government bodies, and company management (Abu Nassar & Humidat, 2014; Thuneibat, 2010).

Mushtahi (2014) found that the first thought or idea that came to mind at the company, whenever a crisis or a major problem occurs, which result in decline in its stock value at the financial market is the idea of changing the auditor.

### 3.2. Auditor report and its types

From the previous, the importance of auditor's report can be seen as a mediator between the auditor who must be the guarantor for the safety and accuracy of financial statements and the users of those statements in making their decisions.

Elder et al. (2010) gave a comprehensive definition of auditor report as a written document issued by a professional person who is eligible to offer a neutral opinion, and provide it to the parties that the auditor checked their financial statements, which indicate in it the followed auditing standards in the audit process, which include the neutral technical opinion about the fairness of financial statements as a whole, the representation level of firm financial position at the end of a specified period, the business results view of its profit and loss, and its cash flows for that period, according to the local or global standards.

The auditor's report is considered the most important element of the audited financial statement of any company, where the auditor expresses his opinion on the financial statements in the auditor's report, and this opinion may be unqualified or qualified.

According to ISA (International Standards on Auditing) (2016), in unqualified opinion, also known as unmodified opinion, the auditor concludes that the financial statements are prepared in accordance with the applicable reporting framework and it's free from material misstatements. But the auditor shall modify the opinion in his report and express a qualified opinion when he concludes by sufficient evidence that misstatements are material but not pervasive, or he is una-

ble to obtained a sufficient evidence, because there is a limitation of scope in his work and the effect of undetected misstatements due to the scope limitation could be material but not pervasive.

### 3.3. Background of Amman Stock Exchange (ASE)<sup>1</sup>

The Amman Stock Exchange (ASE) is a non-profit independent institution that was established in 1999, authorized to function as a regulated market for trading securities in Jordan. On February 2017, the ASE has been registered as a public shareholding company completely owned by government named "The Amman Stock Exchange Company (AS Company)". The ASE company is governed by a seven member board of directors appointed by the Council of Ministers. It aims to operate, manage and develop the operations and activities of securities, commodities, and derivatives markets inside and outside Jordan. The number of subscribed shares in ASE was 6,614,445,693 in 2017.

The ASE classifies companies which are listed on it into three sectors: industry sector, service sector and financial sector, focusing on service sector, which is the adopted sector in this study, the service sector includes 57 companies in 2017, which are classified into 8 sub-groups according to service provided by company: commercial service, educational service, healthcare, hotels and tourism service, media, technology, transportation, and utilities. Service sector had value traded of 374,172,925 and number of share traded 379,760,704 in 2017.

## 4. STUDY METHODOLOGY

### 4.1. Study method

This study is considered an empirical study, it relies on collecting information from its sources and from the field, and depends on studying the event, where first it will search for the service companies that change occurred in it on the auditor report type, either from unqualified to qualified or qualified to unqualified, then specifying the year that auditor report type has been changed in it from unqualified to qualified and vise versa, and then

<sup>1</sup> The information in this section was obtained from ASE website: [www.ase.com.jo](http://www.ase.com.jo)



noticing the average market share price of the company before and after the change, where the average was calculated from three prices of the share, and finally comparing the mean of prices to identify the level of difference, which indicates the existence of financial market reaction on the change of auditor's report type, which means that auditor report has an impact on the stock price and then finding out the type of this impact.

## 4.2. Study sample

Study population contains all the 37 service companies listed at ASE, which the auditor report type in it has changed for the period 2010–2017, either from unqualified to qualified or vice versa, where all the necessary information was available, and a comprehensive survey of all study society was conducted, which includes the companies that experienced change to its report type more than once, where the observations of change on the auditor report type were 48, which are clarified and classified, according to Table 1.

**Table 1.** Study sample and observation

No. of observations	From unqualified to qualified	From qualified to unqualified
N (48) (from 37 companies)	32	16

All these observations have been subject to the statistical analysis.

## 4.3. Study variables

### 4.3.1. Dependent variable (stock price)

The stock price was taken immediately before the issuance of the changed report, which is different from the report of the previous year, and immediately after issuing it, in addition to two prices before and after the date of report issuance. Since the issuance of company reports varies from one company to another, the dates of stock prices also vary from one company to another.

### 4.3.2. Independent variable (change the audit report type)

This occurs when the type of auditor's report changes from the report type in the previous year.

All auditors' reports were reviewed for each company during the study period 2010–2017 and adopt the year in which a different report was issued to monitor changes in share prices. The report issued by the auditors of companies listed on the Amman Stock Exchange explicitly mentions the type of report whether it is a qualified or unqualified report.

## 5. RESULTS

After collecting the necessary data about the companies, which experienced changes to its auditor report type, and then calculating the average for three prices before and after the changed report issue date, first, the normal distribution test to study data was made, then, testing the study hypotheses.

### 5.1. Normal distributions test

To test the normal distribution of data, Kolmogorov-Smirnov test was used. The results were as follows:

**Table 2.** Normal distribution test – Kolmogorov-Smirnov test

Independent variables	Stock prices (dependent variable)	K-S Z value	Sig.
Change from unqualified to qualified	After	1.552	.116
	Before	.994	.246
Change from qualified to unqualified	After	1.221	.101
	Before	1.219	.103

Table 2 shows the normal distribution of data according to Kolmogorov-Smirnov test, if the Sig. value is over than 0.05, then, the data have normal distribution. So, according to the previous table, the data of the study are distributed normally.

### 5.2. Results of first hypothesis test

This hypothesis states that: "There are no statistical differences between the means of stock prices after changing the auditor report type from unqualified to qualified, and the average prices before the change".

Table 3 shows the number of observations that were obtained to test the first hypothesis, and the means of these observations.

**Table 3.** Descriptive statistics for study variables – first hypothesis

Stock price	Mean	N	Std. dev.	Std. error mean
<b>Pair 1</b>				
After	0.7175	32	0.57461	0.10158
Before	0.8850	32	0.75072	0.13271

*Note:* After – average stock prices after changing the type of auditor report from unqualified to qualified. Before – average stock prices before changing the type of auditor report from unqualified to qualified.

**Table 4.** Paired samples correlations

PAIR 1 (Stock price)	N	Correlation	Sig.
<b>Pair 1</b>			
After and before	32	0.826	0.000

**Table 5.** First hypothesis test – paired samples test

PAIR 1 (Stock price)	Mean	Std. dev.	Std. error mean	95% confidence interval of the difference		T	DF	Sig. (2-tailed)
				Lower	Upper			
Pair 1								
After/before	-.16750	0.42575	0.07526	-.32100	-.01400	-2.226	31	0.033

Table 3 showed that number of observations that were obtained from the service companies was 32 observations, where the type of audit report was changed from unqualified to qualified.

For testing the first hypothesis, paired sample T test was used. Table 4 and Table 5 show the test model and the hypothesis testing.

According to Table 5, the value of Sig. as the relative significance was 0.033, which is less than 0.05, which means that there are significant relative differences between the prices before and after the changes, where there is a reduction in the average stock prices after the change in the auditor report type from unqualified to qualified, comparing with the prices before the change, which indicates the rejection of the study's first hypothesis and acceptance of the alternative hypothesis: "There are statistically significant differences between the stock prices after the change in auditor report type from unqualified to qualified, and the prices before the change".

### 5.3. Second major hypothesis test

This hypothesis states that: "There are no statistical differences between the average stock prices after the change of auditor report type from qualified to unqualified and the average prices before the change".

Table 6 shows the number of views or occurrences obtained to test the second main hypothesis, and the arithmetic means of these views.

**Table 6.** Descriptive statistics for study variables – second hypothesis

Stock price	Mean	N	Std. dev.	Std. error mean
<b>Pair 1</b>				
After	.7338	16	.60922	.15230
Before	.7881	16	.66418	.16605

*Note:* After – average stock prices after changing the type of auditor report from unqualified to qualified. Before – average stock prices before changing the type of auditor report from unqualified to qualified.

From Table 6, the number of observations obtained from the service companies were 16 observations, where the type of auditor report was changed from qualified to unqualified, which means that the company was able to clean up its report and this is a serious matter for any company. But it is noticed that average prices after the cleaning report were lower than the prices before that.

To test the second hypothesis and find out the statistical significance, Tables 7 and 8 state the test model and the hypothesis testing.



**Table 7.** Paired sample correlations

PAIR 1 (Stock price)	N	Correlation	Sig.
<b>Pair</b>			
After and before	16	0.971	0.000

**Table 8.** Second hypothesis test – paired samples test

PAIR 1 (Stock price)	Mean	Std. dev.	Std. error mean	95% confidence interval of the difference		T	DF	Sig. (2-tailed)
				Lower	Upper			
Pair 1								
After/before	-.05437	0.16174	0.04043	-.14056	0.03181	-1.345	15	0.199

It notices from Table 8 that the value of Sig., as the relative meaning was 0.199, which is more than 0.05 and means that the meaning differences don't relatively exist between the prices before and after the changes, where it noted a reduction in the average stock prices after the change in the auditor report type from qualified to unqualified compared with the prices before the change, which indicates the acceptance of the study's second hypothesis: "There are no statistical differences for the average stock prices after the change of auditor report type, from qualified to unqualified, and the average prices before the change".

This outcome despite its abnormality, but cleaning the report means that the report was qualified, and this qualification affected the company and led to reduced willingness of shareholders to invest in it, and this influence continued even after cleaning the company's report, which points to the difficulty of restoring the confidence in the company that has been shaken, as a result of getting a qualified report, even if this report was cleaned later to be unqualified report. Therefore, companies must take the necessary steps to avoid getting a qualified report, for any reason, because this would affect the company for a long time, even if this report was cleaned later.

## CONCLUSION

After collecting the data, analyzing it statistically, and testing the study hypotheses, the following conclusions were reached:

- corporate share prices were affected as a result of changing its report type from unqualified to qualified, where the stock prices dropped significantly and were statistically significant;
- change of the audit report from qualified to unqualified (cleaning company's report) didn't have any impact on its share prices, which indicates that restoring investors' confidence and financial market are extremely difficult matters;
- existence of 16 service companies that were able to clean its reports, it's an important notice, and getting the report clean is something rare in the financial market.

## RECOMMENDATIONS

Based on the findings above, the researcher recommends the following:

- the companies should be more concerned about not getting a qualified report, where the important impact on it is reflected in a company stock price;

- cleaning the company's qualified report to be unqualified didn't improve the situation of its share prices, but the negative influence of the qualified report is still in effect, and that led to reduce the stock prices even after cleaning the report;
- conducting similar researches, but on the other sectors to see the impact of auditor report on the prices of companies.

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