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The Effect of Going-Concern Audit Opinion on Market Reaction: Evidence from Indonesia

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Abstract

This study aims to examine the effect of the going-concern audit opinion on market reaction. This study used the event study methodology with 120 days estimation period and 31 days window period. The results of the Wilcoxon signed rank test shows that there is a significant statistical difference in the average abnormal returns between before and after going-concern audit opinion disclosure. It means that going-concern audit opinion has an effect on the market reaction. In conclusion, negative market reaction is indicated by the tendency of decreasing abnormal return value of the stock to negative after disclosure of going-concern audit opinion.

Keywords: Audit Opinion, Going Concern, Assumption.

El efecto de la opinión de la auditoría en marcha sobre la reacción del mercado: evidencia de Indonesia

Resumen

Este estudio tiene como objetivo examinar el efecto de la opinión de la auditoría sobre la reacción del mercado. Este estudio utilizó la metodología del estudio de eventos con un período de estimación de 120 días y un período de ventana de 31 días. Los resultados de la prueba de rangos con signo de Wilcoxon muestran que existe una diferencia estadística significativa en los rendimientos anormales promedio entre la divulgación de la opinión de auditoría anterior y posterior a la inquietud. Significa que la opinión de la auditoría sobre la marcha del negocio tiene un efecto en la reacción del mercado. En conclusión, la reacción negativa del mercado se indica por la tendencia a disminuir el valor de rendimiento anormal de la acción a negativo después de la divulgación de la opinión de la auditoría en marcha.

Palabras clave: Opinión de auditoría, Preocupación en curso, Asunción.

1. INTRODUCTION

Indonesia Accounting Standards No. 1 paragraph 25 required management to make a judgments about the ability of companies to maintain the continuity of their business (going concern assumption) when preparing financial statements. If the company has problem with

going concern assumption, then the company is likely to have difficulty in maintaining its business. Auditor as an independent party also has responsibility to assess the company ability to maintaining their business. If the auditor has a great doubt about the ability of company to maintain its business, then the auditor should give a going-concern audit opinion after evaluating management plan to overcome or mitigate the impact of going concern issue. Most of the study about going-concern audit opinion in Indonesia has been more focused on the determinants of going-concern audit opinion (Junaidi & Hartono, 2010; da Mota Silveira & Martini, 2017).

Elliott (1982) examines the relationship between abnormal return securities and subject to the audit report. The results of Elliott (1982) study showed the presence of negative abnormal return before the date of going-concern audit opinion announcement, but Elliott (1982) cannot find any significant abnormal return over a one week period of going-concern audit opinion announcement, instead, Elliott (1982) found a positive abnormal return for a few weeks after going-concern audit opinion announcement. Dodd et al. (1984) also examine whether the announcement of audit opinion subject to have an effect on stock prices in companies listed on the New York and American Stock Exchange. The results of Dodd et al. (1984) study showed that there are no significant abnormal returns around the date of disclosure of going-concern audit opinion.

Chen & Church (1996) examine the relationship between going-concern audit opinion and market reaction to the bankruptcy filing. The study results show that companies receiving going-concern audit opinion have negative abnormal returns around the date of the bankruptcy filing. Ones examine 68 companies that received going-concern opinion to assess the information content of going-concern evaluation conducted by an independent auditor by testing abnormal returns around the date of the disclosure of the audit report. The study results showed negative abnormal returns around the date of the auditor's report disclosure of firm receiving going-concern audit opinion. Citron et al. (2008) examine whether disclosure of the uncertainty of going concern is price sensitive in the London Stock Exchange (Ianniello & Galloppo, 2015).

The inconsistent results of previous studies about the effect of going-concern audit opinion on market reaction and the absence results of empirical study from Indonesia capital market, hence this study aims to empirically examine the effect of phenomena going-concern audit opinion on market reaction. This study used a sample of all companies listed in Indonesia Stock Exchange from 2012 to 2016 so it can reflect better actual conditions in Indonesian capital market regarding the effect of going-concern audit opinion on market reaction. This study is expected to give contribution both theoretically and practically. The theoretical contribution of this study is expected to expand the literature about the effect of phenomenon going-concern audit opinion on market reaction.

2. LITERATURE REVIEW

Signaling Theory

Signaling theory are useful to describe the behavior when two parties (individuals or organizations) have access to different information. Signaling theory originally proposed by Spence (1973) to explain the behavior of the labor market. Spence (1973) created education signaling models to explain the behavior of the labor market. In the model, education is seen as a potential signal that is able to influence the behavior in the labor market. Signaling theory is further used in the study of accounting and audit which stated that management may provide a signal about the company through the various aspects of the disclosure of financial information, which can be seen as a signal to investors. In addition, investors also may feel that going-concern audit opinion as an early warning of a company's bankruptcy prediction.

Going-Concern Audit Opinion

Going concern is one of the four postulates that the basic concept underlying the historical cost. This postulate is simply stated

that if there is no other evidence to the contrary, it is assumed that the company will continue to run their business until unspecified time limit. Auditor as an independent party has a responsibility to evaluating the viability of company. Based on the audit evidence obtained, auditor should conclude whether, in the auditor judgment, there is a material uncertainty related to the conditions that can lead to significant doubt on the company able to maintain its business continuity.

If the auditor concludes that the use of going concern assumption is appropriate in accordance with the conditions but there is some uncertainty material, the auditor should conclude: (1) if adequate disclosures is included in the financial statements, the auditor should give an unmodified opinion and (2) if adequate disclosures is not included in the financial statements, the auditor should give a qualified opinion or adverse opinion depend on the condition. If the financial statements have been prepared on a going concern basis, but according to the auditor judgment, the use of the base assumption is not appropriate, the auditor should give an adverse opinion (Yang et al., 2019; Soo et al., 2019; Eskandarian et al., 2016).

Market Reaction

Examining the content of information can be used to determine whether there is a market reaction on an announcement. The market

reaction is a form of response given by the market when there is an event announcement. The market reaction indicated the existence of the security price changes and can be measured by using abnormal return. If an event announcement contains information then the announcement of the event will provide abnormal returns to the market, but on the contrary, if there is no information content, the announcement of such events will not provide abnormal returns to the market, the disclosure of going-concern audit opinion by auditor may be regarded as a signal to investors regarding the conditions of a company viability.

When investors look at the going-concern audit opinion in audited financial statements of companies, then investors will be more cautious in making investment decisions at the company. This caution is indicated in response to purchase or sell company stock after the disclosure of going-concern audit opinion. Then, the response from the investors will be reflected on the stock price changes (abnormal return) of companies that receive going-concern audit opinion (Indriastuti, 2019; Rakhmatulloevna, 2016).

3. PROBLEM IDENTIFICATION

The signaling theory explained that management may provide a signal about the company through the various aspects of financial information disclosure, which can be seen as a signal for investors.

Auditors as an independent external party are responsible to assess the company able to maintain its business at the time of companies financial statements audit. Jones (1996) stated that evaluation regarding company continuity (going concern assumption) conducted by an independent auditor will provide useful information to investors. The results of Oreilly (2010) study stated that investors feel going-concern audit opinion become relevant to determine stock prices. Firth (1978) also concluded that investors use the information audit opinion going concern to change their opinion on security. When the company received a going-concern audit opinion, investors will tend to predict a negative market reaction.

Jones (1996) found negative abnormal returns around the date of independent auditor report disclosure for the company receiving going-concern audit opinion. Chen & Church (1996) also found that the company that received a going-concern audit opinion has a negative abnormal return around the date of filing defaults (Citron et al., 2008). The attitude of caution in response to the going-concern audit opinion disclosure will be reflected in the market reaction which is indicated by the changes in stock prices of securities in the form of changes in average abnormal returns stock value before and after going-concern audit opinion disclosure. Therefore, the hypotheses of this study are as follows:

H1: Going-concern audit opinion has an effect on market reaction, which is indicated by the significant statistical difference in

the average abnormal returns between before and after going-concern audit opinion disclosure.

4. METHODOLOGY

Samples

The number of companies listed on the Indonesian Stock Exchange by 2016 as many as 545 companies, but the number of companies listed on the years 2012 to 2016 only about 448 companies. During the 2012-2016 period there are two companies that have delisted, 1 company mergers, 72 companies did not have complete audit financial reporting data, and 86 companies did not have a complete stock price data so that 161 companies were excluded from the sample. A total of 287 companies or 1435 audited financial statements examined to seek going-concern audit opinion. The results showed that there were 29 companies that received a going-concern audit opinion and can be used as the sample of this study. Based on the classification of the Jakarta Stock Exchange Industrial Classification (JASICA), 29 companies of the sample this study covered 8 sectors of 9 sectors companies listed on Indonesia Stock Exchange.

The sample of this study was going-concern audit opinion received by the company in the period of 2012-2016. The number of

going-concern audit opinion received by 29 companies during five years' observation period is 113 going-concern audit opinion. However, there is 20 going-concern audit opinion excluded from analysis because it has a zero stock price during the period of abnormal returns calculation so that the number of final samples was 93 going-concern audit opinion. Most of going-concern audit opinion types in this study were unqualified going-concern audit opinion with an explanatory paragraph as many as 88 samples or 95%, while the remaining 5 samples or 5% receive qualified going-concern audit opinion.

Research Variable

Going-concern audit opinion was proxied with the date of submission of audited financial statements of companies to Indonesia Stock Exchange as the date of going-concern audit opinion disclosure to the market. Market reaction will be measured by abnormal return. Abnormal return is the difference between its actual returns and expected return on each company stock. Abnormal return was calculated by using a formula:

$$AR_{i,t} = R_{i,t} - E(R_{i,t})$$

Where:

$AR_{i,t}$ = Abnormal return for the securities of i at event period of t

$R_{i,t}$ = Actual return for the securities of i atevent period of t

$E(R_{i,t})$ = Expected returnfor the securities of i at event period of t

Actual return was calculated by using the following formula:

$$R_{i,t} = \frac{P_{i,t} - P_{i,t-1}}{P_{i,t-1}}$$

Where:

$R_{i,t}$ = Actual return for the securities of i at event period of t

$P_{i,t}$ = Stock price for the securities of i at event period of t

$P_{i,t-1}$ = Stock price for the securities of i at event period of t-1

To calculate the expected return value, this study uses a mean-adjusted model because it more reflects the condition of the capital market in Indonesia. Expected return with the mean-adjusted model was calculated by using a formula:

$$E(R_{i,t}) = \frac{\sum_{j=t1}^{t2} R_{i,j}}{T}$$

Where:

$E(R_{i,t})$ = Expected return for the securities of i at event period of t

$R_{i,j}$ = Actual return for the securities of i at the estimation period of j

T   = The length of the estimation period, i.e. from t_1 to t_2

Having obtained the abnormal return value, then calculate the average abnormal return by using the formula:

$$AAR_t = \frac{\sum_{i=1}^{k} AR_{i,t}}{k}$$

Where:

AAR_t = Average abnormal return k-securities on day t

$AR_{i,t}$ = Abnormal return for the securities of i on day t

k = The number of securities affected by the announcement of events The target of this proposed work considers the above issues i.e.,

the current research work concentrates on protection of data owner and query user, but not the security of the cloud server since it leases huge storage and estimation power but inputs have no private data..

5. PERFORMANCE EVALUATION

This study examines empirically the effect of the going-concern audit opinion on market reaction. The effect will be seen through the difference of average abnormal returns between before and after going-concern audit opinion disclosure. If there is a significant statistically difference of average abnormal returns before and after going-concern audit opinion disclosure, it can be concluded that going-concern audit opinion has an effect on market reaction, and vice versa. Normality test will be conducted in this study to determine the appropriate statistical test tools to test the hypotheses.

The results of One-Sample Kolmogorov-Smirnov (K-S) test also shows that the Kolmogorov-Smirnov test statistics value (K-S value) of 0.249 and significant at 0.000 (p-value = 0.000 is less than 0.01), which means that the residual data is not normally distributed. Normality test results show the data are not normally distributed, therefore Wilcoxon signed rank test will be used as statistical test tools to test hypotheses of this study. Wilcoxon signed rank test was performed by comparing the value of the average abnormal return

before and after going-concern audit opinion disclosure. The Wilcoxon signed rank test results of this study are shown in Table 1 and Table 2.

		N	Mean Rank	Sum of Ranks
AAR_after– AAR_before	negative ranks	53	45.26	2399.00
	positive ranks	34	42.03	1429.00
	ties	6		
	Total	93		

Table 1: Ranks Results of Wilcoxon Signed Ranks Test

Source: authors' research (IBM SPSS, version 23)

Based on Table 1, it can be seen that there are 53 or 57% negative data which means that 53 samples have been decreased the average abnormal return of stock from the average abnormal return before to the average abnormal return after going-concern audit opinion disclosure. Mean rank or average decrease of the average abnormal return value of 53 samples amounted to 45.26 by the sum of ranks of 2399.00. Table 1 also shows that there are 34 or 37% positive data which means that 34 samples have been increased the average abnormal return of stock from before to after going-concern audit opinion disclosure. Mean rank or average increase of the average abnormal return value of 34 samples amounted to 42.03 by the sum of ranks of 1429.00. Meanwhile, there are 6 or 6% data is the ties data, which means that 6 samples have the same average abnormal return value between before and after going-concern audit opinion disclosure.

Information	AAR_sesudah - AAR before
Z	-2.053
Asymp. Sig. (2-tailed)	0.040

Table 2: Hypotheses Test Results with Wilcoxon Signed Rank Test

Source: authors' research

The hypotheses of this study stated that going-concern audit opinion has an effect on market reaction, as indicated by a significant statistical difference in the average abnormal returns between before and after going-concern audit opinion disclosure. Based on Table 2, it can be seen that Z-value from Wilcoxon signed rank test (Z_{score}) is -2.053, while the value of Z_{table} with alpha 5% or 0.05 is -1.645. This means that $Z_{score} > Z_{table}$, i.e. -2.053 > -1.645. Table 2 also shows that the significance value (Asymp. Sig. (2-tailed)) is smaller than the significance level of 0.05, i.e. 0.04 (0.04 < 0.05). These results indicate that this study rejects H_0 and supports H_1 at a 95% confidence level or at the alpha of 5%. It can be concluded that going-concern audit opinion has an effect on market reaction.

6. CONCLUSION

This study examines empirically the effect of the going-concern audit opinion on market reaction. The results of data analysis using Wilcoxon signed rank test on 93 samples going-concern audit opinion

companies listed in Indonesia Stock Exchange in 2012-2016 showed hypotheses of this study is supported, which means that going-concern audit opinion has an effect to market reaction. The analysis results showed that there is a significant statistical difference in average abnormal return stock companies between before and after going-concern audit opinion disclosure.

Negative market reaction is indicated by the tendency of decreasing abnormal return value of the stock to negative after disclosure of going-concern audit opinion. Based on signaling theory, the results of this study indicate that investors consider the disclosure of going-concern audit opinion as a negative signal or bad news given by an auditor to the market. Interpretation of results in this study needs to consider the limitations of this study. First, the data analysis in this study was not separated based on the type of going-concern audit opinion. Second, most samples in this study were unqualified going-concern audit opinion with an explanatory paragraph. This type of going-concern audit opinion was considered as a good opinion and it can be viewed as a favorable evaluation concerning going concern status, especially among distressed firms.

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