

## EFFECTS OF AUDIT OPINION ON STOCK PRICES IN INDIA

**Author's Name:** Yashpal Meena

**Affiliation:** Assistant Professor, Department of Accounting, FCMS, Jai Narain Vyas University, Jodhpur, India

**E-Mail:** [ashokkumarhatwal@gmail.com](mailto:ashokkumarhatwal@gmail.com)

**DOI No. – 08.2020-25662434**

### *Abstract*

*The purpose of the research was to look into the impact of altered audit judgments on stock prices. During the research period, a survey was conducted on a corporation that has been continually listed in the National Stock Exchange of India. Among some information gathered were audit opinions, financials, everyday stock values, final stock values, weekly average share prices, outstanding shares, and cost of equity capital.*

*The mean and standard deviation were computed and compared for final stock prices, book value of equity, shares outstanding, and weekly average share prices. The study's findings demonstrated a negatively significant association between audit views and share prices, with the auditor's report accounting for just a tiny amount of stock price change. The research also suggests that the CMA make interim audit reports necessary for all publicly listed firms during the fiscal year, because this knowledge is represented in stock values as quickly as possible.*

**Keywords:** Audit, Financials, Share, Prices, Firms

### **INTRODUCTION**

A country's economic progress is measured by means of investing activities, that are influenced by the financial state of the firm. As a result, financial statements are regarded as a significant instrument for making investment decisions, but openness of information revealed in financial statements is required for this purpose. Audited financials serve as a way of dialogue among auditors and investment policymakers, helping to clarify information and reduce uncertainty.

### **AUDIT REPORT**

The influence of the audit report's content, particularly the audit opinion, on the share value or return is separated into two categories: assessment of the audit report's impact and analysis of the auditor's effect on the share price or yield. The literature has emphasised the most important reasons why an audit report's content may impact the price of the stock.

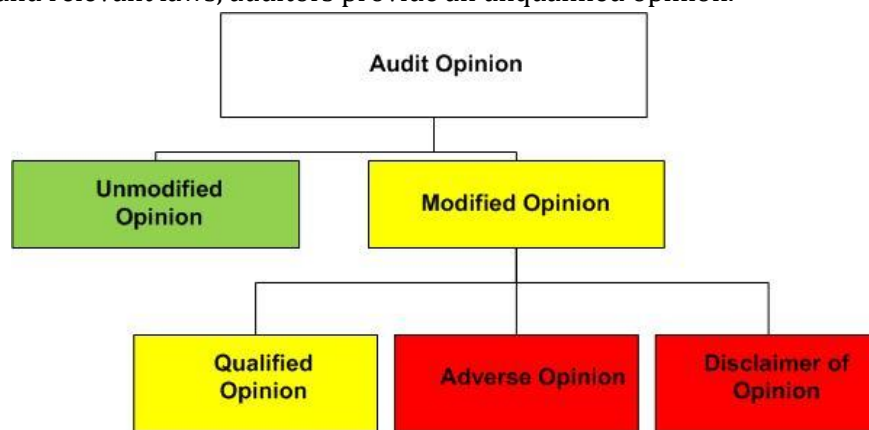
For starters, the audit report may hold data that alters estimations and risks related to future revenues that may be realised (Itonen, 2012), which is important to stockholders.

Furthermore, the audit report may provide meaningful data on the organization's capacity to keep functioning. Investors perceive this arrangement to be secure since auditors have access to a company's internal information, and the audit report reflects this confidential information.

### **WHAT IS AN 'AUDIT OPINION' ?**

The audit opinion is a declaration issued by independent auditors in reaction to their evaluation of the financial statements of their client. Unmodified and Modified audit opinions are the two basic categories of audit opinions.

When financial statements are produced in all important aspects and comply with accounting principles and relevant laws, auditors provide an unqualified opinion.



Source:- Authors presentation

Mainly three opinions are provided for updated views on accounting records which are not created in a meaningful way in relation to other items. Stakeholders are worried about a changed audit opinion provided by the auditor since it is the source that tells them if the analysis of the financial statements they use is valid.

### THE AUDIT OPINION HAS INFLUENCE ON PRICES OF COMPANY STOCKS

When a company hires external auditors, the audit firm's reputation has a substantial impact on the company's stock price because investors look at the audit firm's reputation and respond appropriately. When audit businesses' reputations suffer, their customers' stock values must endure large losses as well.

Because audited financials seem to be the end result of the process of auditing, the auditing process's integrity effects investing strategies anytime audit reports are considered as the primary resource. Changes in share prices detect differences in capital choices taken by financial stakeholders, and so such influences are reflected in publicly listed enterprises' share prices.

Financial insights reported in financial statements is common knowledge to all investors, therefore the signature of an auditor, a practising CA, increases confidence in it, reducing discrepancies in investors' appraisals of firm worth. As a result, investors rely heavily on audited data, and it has been discovered that auditing has a positive impact on trading volume and company stock returns.

### LITERATURE REVIEW

According to **Altman and McGough**, 46.4 percent of failed corporations received the "going-concern opinion." When Deakin looked at cases two and three, he discovered that 14.9 percent of the bankrupt corporations had gotten a "going-concern" opinion. Alternative research developed models to help auditors make going-concern decisions.

**Spathis** has created a methodology to explain qualifications in audit reports of Croatian and Slovenian corporations based on financial data and other indications such as firm litigation. The entire sample of 50 qualifications and 50 without qualifications was accurately identified with accuracy rates of roughly 78 percent and 75 percent, respectively (logistic and OLS models).

Caramanis and Spathis evaluated a logistic and OLS regression model on a sample of 185 Croatian and Slovenian companies mentioned on the Zagreb Stock Exchange and Slovenian Stock Exchange. On the other hand, some financial factors (operating income/total assets and current ratio) are good predictors.

Hoti et al. (2012) explored how audit opinions affect share prices and discovered how share prices change in response to audit opinions from auditors. Because investors seek quality audits and auditors' opinions, audit quality and auditors' opinions have a substantial impact on stock price changes. Consider auditors' opinions to be a credible source of news regarding a corporation's financial statement.

## OBJECTIVE

The current study's goal and motive is to find out whether an auditor's view on a firm listed on the NSE of India has an impact on stock prices. The current study will provide an academic contribution to stock exchange research and also a practical contribution to stakeholders and investors by emphasising the impact of audit, allowing them to feel confident in their investment decisions in a corporation.

## METHODOLOGY

The goal of this study is to examine the impact of the audit report prepared at the time of the publication of financial statements on investors' decisions represented through stock prices, which are characterised by the relative variance of stock prices over time. This research has limitations due to the fact that only publicly traded companies were included in the statistical analysis.

## DATA COLLECTION

For the purpose of study, we have taken following co.'s listed on Stock exchange

### 1. COAL INDIA

The auditor provided an unaltered opinion and emphasised the following as important audit issues. (The key audit issues are those that, in the auditor's professional view, have been the most significant in the financial statement audit for the period.)

Observation of Secretarial Auditor

1. The Board lacked at least half of the directors as independent directors, as well as an independent woman director. From September 6, 2020, the Audit Committee, Nomination and Remuneration Committee, Corporate Social Responsibility Committee, and Stakeholder Relationship Committee were not formed in accordance with SEBI LODR, 2015, and the business required to be transacted at these committee meetings is subject to compliance with SEBI LODR 2015 regulations 17, 18, 19, 20, 21, 24, 33, and Schedule II. Whilst the time under study, changes in the composition of the Board of Directors were made without complying with the aforementioned provisions.

2. With respect to the aforesaid regulations, the BSE Limited and the National Stock Exchange of India Limited have imposed penalties on the Company for the quarters of Mar'20, June'20, Sept'20, and Dec'20.

### 2. L&T

The auditor provided an unaltered opinion and emphasised the following as important audit issues. (Key audit matters are those that, in the auditor's professional opinion, were the most important in the period's financial statement audit.)

### Key audit Matters Highlighted

Measurement of loan assets:

Loan assets totaled Rs. 78,593.64 crore as of March 31, 2021 (net of expected credit losses and fair value fluctuations), accounting for 82 percent of the Company's total assets. Loan assets worth Rs 55,715.97 crore and Rs 22,877.67 crore, respectively, are valued at amortised cost and fair value. In identifying these loan assets and applying suitable measuring criteria, significant judgement is used. The allowance for expected credit losses ("ECL") and fair value of such loan assets are essential estimates that require more managerial judgement. We assessed that the provision for ECL and fair valuation on loan assets have a high degree of estimating uncertainty, with a wide range of plausible financial statement outcomes as part of our risk assessment.

### 2. HDFC Bank

The auditor provided an unaltered opinion and emphasised the following as important audit issues. (Key audit matters are those that, in the auditor's professional opinion, were the most important in the period's financial statement audit.)

### Key audit Matters Highlighted

- a) Impairment of client loans, including off-balance-sheet items
- b) Information technology (IT) systems and controls The Corporation's key financial accounting and reporting processes are highly reliant on information systems, including automated controls in information systems, so there is a risk that gaps in the IT control environment will cause financial accounting and reporting records to be incorrectly recorded. For its overall financial reporting, the Corporation employs a number of systems.

### CHANGE IN PRICE

S.No.	Industry	Company	Date of release of financial	Stock price day Before(approx.)	Stock price day after (approx.)	Observation
1	Finance	L&T FH	28 July 21	86.25/share	89/share	Rise
2	Bank	HDFC Bank	21 June 21	1480/Share	1484/share	Rise
3	Power	Coal India	13 August 21	144.5/share	144/share	Fall

### FINDINGS

**Sample collected contains an unmodified opinion in all cases, showing weekly positive or almost no change in price due to audit opinion.**

However, this is not the whole truth as auditors' opinion is not the only factor affecting price of the stock. The price of a stock is impacted by a number of variables, the most important of which are supply and demand, business financial results, and general economic patterns. Auditors' opinion a part of annual report is not the only factor affecting stock price.

### Other factors that can affect stock prices

- Earnings and profit announcements, as well as future earnings estimates.
- The declaration of dividends

- The launch of a new product or the recall of an existing one.
- Obtaining a significant new contract
- Layoffs of employees.
- The possibility of a takeover or merger.
- A shift in leadership.
- Blunders or controversies in the accounting department.

## CONCLUSION

A clean report is something which has received an unqualified evaluation. This is perhaps the most common kind of auditor report. This is also the sort of report which most businesses anticipate receiving. An unqualified opinion contains no unfavourable remarks or disclaimers concerning any laws or the audit procedure. The auditors are happy with the organization's monetary reporting, according to this report. As per the auditor, the organization's actions are in good compliance with the applicable governance principles and rules. The company, the auditors, the investors, and the public at large all believe that this statement has no substantial inaccuracies. Such positive statement is likely to have weekly positive or no effect on stock prices of a company.

However, studies show

- **Qualified Opinion-Qualified Report-**

When an auditor has reservations about a particular operation as well as transaction, he/she could choose to issue a qualified review instead of a clear report. Investors dislike qualifying remarks because they give an unfavourable view of a firm's financial position.

- **Disclaimer of Opinion-Disclaimer Report-**

When an auditor issues a disclaimer of opinion report, they are indicating that they will not be expressing any opinion on the financial statements. Auditors may declare a disclaimer of opinion if they believe the company has hampered their capacity to perform a complete audit or if they have not received adequate answers to their concerns. A disclaimer of opinion, according to most people, is a rather harsh position. As a result, the company's image suffers as a result.

- **Adverse Audit Report - Adverse Opinion-**

An unfavourable audit opinion is the final form of audit opinion. Auditors who are dissatisfied with the financial statements or find a high degree of major misstatements or irregularities are aware that this may cause investors and the government to distrust the company's financial reports.

A poor perception of an auditor is a huge warning sign. A negative audit report is often issued when financial records exhibit significant mistakes and the possibility for deception. Adverse sentiments are a warning sign that the corporation's economic statements have not yet been maintained in compliance with GAAP. Financial institutions and investors will stop doing business with the organization as a result of this ruling.

Corporations, investors, and the wider populace place a great value on unqualified reports. The presence of an unqualified audit opinion can result in investors withdrawing their funds, a negative public image, and the imposition of penalties, all of which can damage the share price of a stock.

## REFERENCES

- Al-Thuneibat, A. A., Khamees, B. A. and Al-Fayoumi, N. A. (2007). The Effect of Qualified Auditors' Opinions on Share Prices: Evidence from Jordan. *Managerial Auditing Journal*. 23(1), 84-101.
- Al-Thuneibat, A., Abedalqader, A., Baker, R. T. I. and Ata, R. A. (2011). Do Audit Tenure and Firm Size Contribute to Audit Quality? : Empirical Evidence from Jordan. *Managerial Auditing Journal*. 26(4), 317-334.
- Anavarkhatibi, S., Safashur, M. and Mohammadi, J. (2012). The Effect of Auditors' Opinion on Share Prices and Returns in Tehran Stock Exchange. *Research journal of Management Sciences*. 1(1), 23-27.
- <https://www.hdfc.com/digital-annual-report-2020-2021/>
- <https://www.ltfs.com/content/dam/Int-financial-services/Intfamilycredit/Documents/familycreditinverstors/financials/Annual%20Report%20FY%2021.pdf>
- <http://kb.icai.org/pdfs/PDFFile5b3b49f185fbf5.16066109.pdf>
- <https://www.sciencedirect.com/science/article/pii/S1755309114000392>
- <https://insights.diligent.com/audit-reporting/understanding-four-types-audit-reports/>
- <https://www.wikiaccounting.com/audits-opinion-unmodified-unqualified-and-modifiedqualified-disclaimer-adverse/>
- <https://www.assetinfinity.com/blog/stock-audit-process-importance>