



Key Audit Matters in Auditor's Report as Moderate Effect on Stock Price

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Abstract

This research aims to focus on the relationship between information of an auditor's report and stock prices of listed companies in the Stock Exchange of Thailand (SET). The information based on the opinion of the auditor and key audit matters (KAMs) which are mentioned in the report are particular issues of this research. The key financial information of 2016, the auditor's reports of 2017, and the stock prices of the 365 Thai listed companies at and after the auditor's report date are collected. Using a three-level hierarchical regression model to prove the related hypotheses, the results show that the opinion of the auditor has a weak significant relationship with the stock price. Similarly, KAMs, which are highlighted in the report, also have a weak effect on the stock price. Interestingly, when the auditor's opinion and KAMs are considered together, it results in a strong influence on the stock price of the listed firms. Therefore, this can indicate that a mix of the auditor's opinion and KAMs provides useful information for investors in making their decision in the stock market

Keywords: Auditor's report, opinion of auditor, key audit matters, stock prices

1. Introduction

The International Auditing and Assurance Standards Board (IAASB) worked on and adjusted the auditing standard no.700 for the opinion of the auditor on financial statements. The standard introduced the new auditor's report in the year 2015. The main purpose of the report is to provide useful information which fit the need of the investors. In Thailand, the Thailand Federation of Accounting Profession (TFAC) also launched the auditing standard no.700 (adjusted B.E.2559). It has been enforced for the financial statements which reported since the year ended 31 December 2015 (B.E.2559) (Federation of Accounting Profession, 2016b).

The particular differences between the new auditor's report and the previous one are that the new report will first state the opinion of the auditor, followed by the basis for the opinion. In addition, the new section, namely "Key Audit Matters: KAMs", is included. The new paragraph is the crucial data, such as corporate governance issue, significant risk, evidence that the auditor has found, leading the audit to change a strategy in the auditing process, and confirm that the going concern basis still the appropriate basis for the firm. The main purpose of the new auditor's report is to increase the assurance to financial statements, reflecting transparency of information which leads to an increase in benefits for the users or investors.

According to the new information in the new auditor's report, and as well the purpose of the report, the investigation for the real benefits to investors is the main issue. Therefore, this study tries to testify the association of information in the auditor's report, i.e. opinion of auditor and KAMs, with a stock price of listed companies in the Thai stock market. In examining, the three-level hierarchal regression model is applied as a tool for testing the hypothesis, while some data which related to decision making of investors, such as earning per share, book value of stock, firm size, audit firm size as per reports of Buachoom and Donpad, 2018; Feltham, & Olhson 1995; and Li Yutian, 2013, which are also included as control for the relationship.

2. Objectives

This study aims to examine the association of information in the auditor's report including the opinion of auditor and KAMs, with a stock price of listed companies in the Thai stock market.



3. Literature Review and Hypotheses Development

Auditing standard no.701 for audit matters communication states that auditor should identify significant audit matters and communicate them to executives who get involved in the governance of the firm to take into the account for avoiding the risk of reporting and for using the data for decision making (Federation of Accounting Profession, 2016C). Additionally, auditing standard no.315 (adjusted B.E 2557) recommends that auditor should explain each key matter which found in auditing process within the KAMs section, while audit standard no.570 (adjust B.E.2559) indicates that auditor should also report about going concern issue based of the audit evidence. (Federation of Accounting Profession, 2014; 2016a)

To support the benefit of the KAMs, Tangruenrat (2009) reports the opinion of financial statement users toward the auditor's report, indicating that they accept the original auditor report with standard sentence in the report, but they require the auditor to explain or provide more information about the issues which may benefit to financial statement users. This consists of Porter, ÓhÓgartaigh and Baskerville (2009) which state that some financial statements users want to know some information rather than standard information within the auditor's report. Furthermore, IAASB (2011) notes that financial statements users require an auditor to report audit matters which found on the auditing process, because it may help the users derived useful information about corporate governance and transparency. As per investors and analysts, they also want auditors to identify issues which affect their decision making (Ciesielski & Weirich, 2012). This evidence indicates the importance of the financial statements with transparency basis, signaling the financial statement users to get a useful source for their decision making (Dye, 1993). In a nutshell, KAMs in auditor's report help to increase the communication quality of financial statements as per signaling theory perspective (Lazarevska & Trpeska, 2016; Spence, 1973). The theory states that signal is communication any information from one source or "sender" to other persons or "receivers". The purpose of signaling is to provide better information to receivers. And then the receivers will interpret and evaluate the information by themselves (Certo, 2003). On the other hand, the sender expects the receivers to believe in their information (Chatiwong, 2017). Some previous studies, such as Herbig and Milewicz (1996), confirm that the stock market responds to the information in the market as per the signaling theory. This can be implied that KAMs in auditor's report should be a signal which is sent to investors in the stock market and affects their decision making when considering in term of stock price change (Dye, 1993).

The previous evidence, such as Dodd, Dopuch, Holthausen, & Leftwich, 1984 reveal that the auditor's opinion influences on decision making of investors, while Jones (1996) and Fleak and Wilson (1994) Chow & Rice (1982) and Dopuch, Holthausen, & Leftwich, (1986) report that rate of return on stock normally change during auditor's report announcement, e.g. when auditor provides qualified opinion on the report, it leads to a decline of stock price. This is similar to the evidence of Blay and Geiger (2001) which shows that the market negatively responds to a qualified opinion, adverse opinion, and disclaimer of the opinion of the auditor. The response of the market usually reflects from the issues in the auditor's report, for example, there is significant information is not report correctly, there is no satisfied audit evidence, and unable to predict the effect of event or issue which have no evidence to support. (Federation of Accounting Profession, 2016d). However, there is a number of prior studies, such as Elliott (1982), and Herbohn, Ragunathan and Garsden (2007) argue that there is no effect of information from auditor's report on the stock price.

Interesting perspective, Christensen, Glover, and Wolfe (2014) reveal that KAMs in auditor's report affect the decision making of investors, rather than information in the previous version of the report. Especially, Menon and Williams (2010) state that stock price dramatically declines when auditor's report mentions the going concern issue. In Thailand, Srijunpetch (2017) examine the association of KAMs and information in financial statements and respond of investors for the year 2015 to 2016. The result shows that KAMs has a significant positive effect on the volume of stock trading. According to this evidence, it indicates that opinion and KAMs in auditor's report have a relationship with the stock price as per the following hypotheses and research framework.



H1: Opinion of auditor is related to stock price
H2: Opinion of auditor is related to stock price moderated by key audit matters

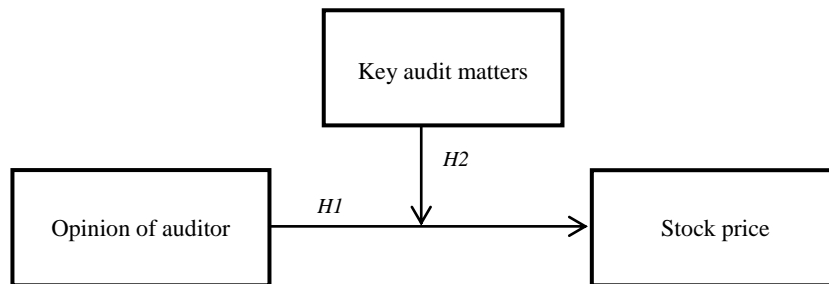


Figure 1 Research framework for the information in auditor’s report and stock price relationship

4. Methodological Approach

4.1 Population and samples

There are 559 listed firms on 24 November 2017 as the population of the study. This study chooses the samples by a specific method from companies with accounting period ended on 31 December. Moreover, companies with financial distress, property fund, financial institute, and companies without significant information related to the objective of the study are excluded. Finally, there are 365 final samples for this study.

4.2 Data collection

Data which were collected in this study composed of 1) the opinion of the auditor on the auditor’s report 2) KAMs, in terms of asset, liability, revenue, expense, and going concern, from the auditor’s report, 3) the closing price of stocks of the sample companies 5 days after the auditor’s report date, and 4) control variables including firm size, audit firm size, earnings per share, and book value per share. All of these data were collected from the database of the SET.

4.3 Empirical models

$$SP_{it} = \beta_0 + \beta_1 FS_{it} + \beta_2 AFS_{it} + \beta_3 EPS_{it} + \beta_4 BV_{it} + \varepsilon_{it} \quad \dots (1)$$

$$SP_{it} = \beta_0 + \beta_1 FS_{it} + \beta_2 AFS_{it} + \beta_3 EPS_{it} + \beta_4 BV_{it} + \beta_5 KAMs_{it} + \varepsilon_{it} \quad \dots (2)$$

$$SP_{it} = \beta_0 + \beta_1 FS_{it} + \beta_2 AFS_{it} + \beta_3 EPS_{it} + \beta_4 BV_{it} + \beta_5 Opinion_{it} + \beta_6 Opinion * KAMs_{it} + \varepsilon_{it} \quad \dots (3)$$

Where; SP = stock price (5 days average after auditor’s report date)

Opinion = Opinion of auditor

KAMs = Key audit matters

FS = firm size

AFS = auditing firm size

EPS = earnings per share

BV = book value per share



For testing hypotheses in according to empirical models, the three-level hierarchical regression model is applied. There are three groups of variables according to the empirical models. Firstly, the dependent variable is stock price (SP) which measured from the closing price of the stock of the sample companies for 5 days average after auditor's report date. Secondly, independent variables composed of the opinion of an auditor and KAMs. The opinion of the auditor is measured by a dummy variable, given 0 for unqualified opinion and given 1 for other cases. Meanwhile, KAMs are also measured as a dummy variable, it will be given 1 when any key audit matters reported, and value 0 if it is not the case. The last group of variables is the control variables. They are firm size (FS) which measured by natural logarithm of total assets; (AFS) audit firm size which measured by dummy value as value 1 when audit sample companies audited by one of the big 4 audit firms; earning per share (EPS) measured by total profit to total number of shares, while book value per share (BV) is measured by book value of sample compared to total shares of the firm.

5. Results of the study

5.1 Descriptive result

Table 1 illustrates descriptive data of related variables. For the stock price, the stock price of each sample company after the auditor's report date for the year 2017 has a quite high standard deviation with closing price 5 days average after the report at 32.37 THB. When considering the opinion of the auditor on financial statements of the companies in 2016, 82.51% is unqualified opinion, and 17.49% is a modification to the opinion. When focusing on KAMs, nearly half of the samples, 47.58% is reported the KAMs, while 52.48% of auditor's reports have no information about KAMs. Earnings per share, book value per share and firm size figures show average value accounted for 1.64, 14.58 and 22.67, respectively, with low standard deviation. For audit firms of sample companies, 64.10% is big audit firms, and 35.90% are local firms.

Table 1 Summary statistics for variables characteristics

Variables	Percentage	Mean	Median	S.D.	Min	Max
Stock price 5 days average after auditor's report date		32.37	7.20	163.27	0.03	299.50
Opinion of auditor with unqualified	82.51					
Opinion of auditor with modification	17.49					
Auditor's report with KAMs	47.58					
Auditor's report without KAMs	52.42					
Earnings per share		1.64	3.64	6.65	-17.44	110.62
Book value per share		14.58	22.47	48.61	0.14	907.04
Firm size*		22.67	0.31	1.51	19.77	28.43
Big audit firm	64.10					
Local audit firm	35.90					

Note: unit of variables with * is natural logarithm

5.2 Empirical result

Table 2 indicates empirical evidence from the three-level hierarchical regression model for the relationship between information in the auditor's report and stock price of listed firms, under considering KAMs as the moderate variable. Particularly, the adjusted R-square figures increase continuously from level 1 to level 3, indicating that variables which are added to each level encourage the explanation power of the empirical models.

In level 1, the influence of control variables on stock price is determined, and the results show that earnings per share, book value per share, firm size, and audit firm size also have a significant relationship with the stock price at $p < 0.001$.

For level 2, both control variables and independent variable, i.e. KAMs, are examined their effects on the price of the stock. The results indicate that KAMs have a weak negative impact on stock price of 5 days average after auditor's date, with $p < 0.10$. As empirical evidence shows that KAMs results in a react to



firm stock price, it means that information related to KAMs in the auditor's report can be one of the signals to the investors.

Level 3 of the three-level hierarchical regression also show evidence that auditor's opinion has a weak influence of on stock price. This implies that standard information in the auditor's report has less meaning to convince behavior of the investors in responding to the market. Hypothesis 1 is, therefore, marginally accepted with weak evidence of auditor's opinion and stock price relationship. Surprisingly, the interaction figure between auditor's opinion and KAMs revealed that it has a significant positive effect on the stock price at $p < 0.01$. In effect, Hypothesis 2 is supported when KAMs as a moderate variable on auditor's opinion and stock price relationship can make this relationship stronger. It can be concluded that KAMs can represent the useful information which fulfils the need of the financial statement users. They may have more crucial information to support the auditor's opinion in making the decision of investors in responding to the stock market.

Table 2 Relationship between information in auditor's report and stock price

Independent variables	Dependent variable: Average Stock Price		
	Level 1	Level 2	Level 3
Constant	4.255* (1.830)	4.115** (2.301)	4.235** (2.215)
Level 1: Controls			
Earnings per share	0.324*** (4.445)	0.322*** (4.021)	0.613*** (4.124)
Book value per share	0.084*** (2.925)	0.091*** (2.454)	-0.065*** (-2.932)
Firm size	-0.224*** (2.673)	-0.422** (1.920)	0.294* (1.653)
Big audit firm	0.434*** (2.821)	0.429** (2.280)	0.497*** (2.775)
Level 2: Independent			
Key Audit Matters		0.129* (1.651)	0.204* (1.854)
Level 3: Hypotheses tests			
Opinion of Auditor: <i>H1</i>			0.048* (1.651)
Opinion of Auditor* KAMs: <i>H2</i>			0.183*** (2.962)
R²	0.215	0.262	0.289
Adjusted R²	0.206	0.251	0.275
F	8.23	9.64	10.11
Number of samples	365	365	365

Note: 1) The t-statistic is reported in parentheses.

2) ***, **, and * denote significant level at < 0.01 , < 0.05 , and < 0.10 , respectively.

6. Conclusion and discussion

This study aims to investigate the relationship between the opinion of auditor and stock price and determine the moderate effect of KAMs on the relationship in the Thai stock market.

When auditor's opinion and KAMs have a weak effect on stock price, whereas an interactive variable between the auditor's opinion and KAMs leads to a significant effect on the stock price of the firm. Hence, KAMs are indicated as particular information which can increase the trust of financial statement users to support their making decision. This consists of the previous studies in developed countries such as



Christensen et al. (2014) who concludes that overall auditor's report information results in the decision making of investors.

In line with the empirical results, this study encourages related market participants to pay more attention to KAMs together with the opinion of the auditor in considering trading their stock in the market. The particular KAMs could help investors make their decision to invest in the appropriate firms.

Furthermore, according to the results of this study, it can recommend two crucial points. The first point, KAMs which related to the quality of financial statement should notify the TFAC, the SET, the SEC and also listed firms in following up auditing standard no. 701 to provide significant information to the auditor, resulting in informing data to the financial statement users or investors. The second point, for the future study, KAMs in auditor's report should be followed up that whether it can help to improve the quality of financial statements of listed firms or not.

7. References

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