

CHAPTER I

INTRODUCTION

1.1 Background

According to Ross et al. (2016), firms need to meet some requirements such as size of assets and number of shareholders to be listed in an exchange. Then, it can be traded by traders and investors in the exchange. Robu and Robu (2015) stated that rational investors will always find financial placement with high return and low risk in an efficient financial market. To get low risk, investors need the management to give correct information about the companies. This can be done by the help of audit services which are done by a professional and independent auditor. Audit services are demanded by users of the financial statement to avoid unreliable information due to remoteness of information, biases of the preparer, complex data and transactions. Those audit services will include audit reports to help investors in making their decisions (Arens et al., 2017).

Audit report contains audit opinion. Audit opinion is the summary of the whole audit report. It is referred as an opinion as it is based on the independent auditor's judgement (Arens et al., 2017). According to SA 705, there are three modified audit opinions, which consists of qualified audit opinion, adverse audit opinion, and disclaimer of opinion. According to Ianniello and Galloppo (2015), audit opinion is separated into two, which is qualified opinion and unqualified opinion.

According to Wu et al. (2020), the outbreak started in a market in Wuhan, China in the last month of 2019. Its pathogen was known as a novel beta-coronavirus and called 2019 novel coronavirus. It brought back memories of another beta-coronavirus in the year of 2003. During the first month of 2020, the source of the outbreak was shut down. However, people in the other provinces started to get the disease, and it even spread to other countries. It can spread only by the expose to people's droplets or by contact.

Previous study mentioned that an unqualified opinion with an emphasis of matter paragraph regarding uncertainty about going concern or financial distress affects stock prices positively, as stated by Ianniello and Galloppo (2015). This means that unqualified opinion with an emphasis of matter paragraph will result in stock prices going up. Robu and Robu (2015) research also stated that in Romania, the public companies listed in the stock exchange, information in the audit report has a significant effect on the stock return, depending on the audit opinion and Big 4. Dewi and Badera (2016) also stated that there is a change in the stock price before and after that release of audit report which contain unqualified opinion. However, another research by Mustikarini and Samudera (2017) mentioned that the issuance of modified audit opinion does not have effect towards investors. Another similar research is by Supriati et al. (2021), which stated that their research result showed that unqualified opinion with emphasis of matter paragraph affect abnormal return negatively and significantly. Whereas in a study by Lin et al. (2011), modified audit opinion does not always show big negative effect towards the company value.

Modified audit opinion also does not always form a substantial negative effect on the company's investment and financing activities.

In response to the pandemic as mentioned by Wu et al. (2020), a study by Crucean and Hategan (2018) mentioned that during COVID-19, some events that occurred due to the COVID-19 affect the financial statements. Because of this, there may be more modified audit opinion during COVID-19 and hence, this can affect the relationship between market reaction toward modified audit opinion during the pandemic. According to Barbour (2020), ICAS even updated the guidance for auditors due to the COVID-19. Additional content is made in paragraphs 1.4, 1.5 and 4.7 to give a better detail compared to the previous one. The impact of COVID-19 is that auditors have difficulty in the mobility and travelling, resulting in another difficulty in collecting enough audit evidence on inventory. This may modify the audit opinion due to the lack of audit evidence. However, ISA 501 stated that auditor may do another alternative procedure to collect enough audit evidence with considerations.

ICAEW also mentioned that auditor may consider issuing an additional paragraph, which is the emphasis of matter paragraph, in the audit opinion due to COVID-19. This is because COVID-19 may have a significant effect towards the company's financial position. This can be seen from the lockdown, where people had trouble in buying things outside, and many stores closed as no customers went to their stores during the lockdown. ACCA also mentioned that COVID-19 may result in uncertainty and cause auditors to include an emphasis of matter or other

matter paragraph in the audit opinion to emphasize on the uncertainty due to the COVID-19.

Therefore, I chose this topic because the results of the previous studies are not consistent. This topic is also still rare in Indonesia. This research is made based on all public companies listed in Indonesian Stock Exchange except for finance sector. This is due to the reason that finance sector has a high leverage, compared to the other sectors. To conclude, the writer came up with the title of “**MARKET REACTION TOWARD MODIFIED AUDIT OPINION: EMPIRICAL EVIDENCE FROM PRE AND AT PANDEMIC PERIOD**”

1.2 Research Problem

According to the writer, the research problem in relation with the background is as follows:

- 1) Does Modified Audit Opinion affect Market Reaction?
- 2) Does Modified Audit Opinion affect Market Reaction more in the pandemic era?

1.3 Research Objectives

According to the writer, the objectives for this research are as follows:

- 1) To prove empirically that there is an impact of Modified Audit Opinion towards Market Reaction.
- 2) To prove empirically that there is a bigger impact of Modified Audit Opinion towards Market Reaction in the pandemic era.

1.4 Significance of Study

1) For Students

This research is expected to give students a better understanding on how to implement theories in the real-life regarding variables that may affect the market reaction.

2) Future Researchers

This research is expected to provide future researchers more understanding for future studies relating to Market Reaction, especially the effect of Market Reaction towards Modified Audit Opinion: Empirical Evidence from pre and at Pandemic Period.

3) For Investor

This research is expected to raise investor's understanding of the impact of Modified Audit Opinion towards Market Reaction.

1.5 Scope of Study

In this research, the writer examines one independent variable, which is market reaction. The financial data obtained will be from public companies that are listed in the Indonesian Stock Exchange. This research is also limiting the observation years to three years, which are 2018, 2019 and 2020. Another limitation on this observation is to exclude companies reporting their financial statements in USD.

1.6 Systematic Discussion

This research paper is divided into five chapters, which consist of the following:

CHAPTER I: INTRODUCTION

In this chapter, the writer will discuss the background, research problem, research objectives, significance of the study, scope of the study and systematic discussion of the research.

CHAPTER II: LITERATURE REVIEW

In this chapter, the writer will discuss further regarding the research's basic concept definition, literature review, conceptual framework and hypothesis development.

CHAPTER III: METHODOLOGY

In this chapter, the writer will discuss the population and sample, data collection method, empirical model, definition of operational variable and data analysis method.

CHAPTER IV: RESULTS AND DISCUSSION

In this chapter, the writer will discuss the results and empirical findings in the research relating to the effect of Market Reaction towards Modified Audit Opinion: Empirical Evidence from pre and at Pandemic Period.

CHAPTER V: CONCLUSION AND RECOMMENDATIONS

In this chapter, the writer will make a conclusion from the research, as well as a summary of the important points of the research. Suggestions will also be made from the research.