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Investor Sentiment and Auditor's Going Concern Opinion: Examining the Accuracy of the Auditor's Opinion and Market Reaction to It[1]

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Research Paper

INTRODUCTION

Many researchers have studied investor sentiment and its impact on financial markets. The evidence shows that managers exploit the high sentiments of investors with their opportunistic behavior. Considering the potential impact of investor sentiment on financial reporting motives, we can expect a relationship between investor sentiment and risk assessment by the auditors and their reporting.

Independent auditors must validate the financial reports and they play an important supervisory role in solving agency problems. Investor sentiment can increase audit risk by affecting managerial incentives for misreporting. The auditor's conservative report through a going concern opinion is an example of a logical response to increased audit risk. This view predicts a positive relationship between investor sentiment and the possibility of the going concern opinion. In another perspective, auditors' motivations may establish a negative relationship between investor sentiment and audit risk.

The present study studies the relationship between investor sentiment and auditors' assessment of audit risk. For this purpose, the relationship between investor sentiment and the probability of the going concern opinion is studied. Then, the effects of sentiment on the accuracy of the auditor's concern opinion were investigated. At the end of the research, the

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market's reaction to the going concern opinion, in periods with high and low sentiments of investors, has been compared with each other.

MATERIALS AND METHODS

The sample contains all companies accepted in the Tehran Stock Exchange during the years 2013 to 2020 that have the following conditions:

1. They should not be in the financial industry contains investment companies, banks, insurance, and leasing.
2. Company information is available.

Thus, 340 companies (1942 observations) were studied in this research.

To test the hypotheses, logistic regression has been used with the control of industry effects. Hosmer-Lemeshow tests and prediction accuracy percentage criteria have been used to check the goodness of fit of the models. Variance Inflation Factor (VIF) was used to detect collinearity. Findings show that independent variables do not have collinearity problems.

RESULTS AND DISCUSSION

The model investigates the relationship between investor sentiment and the probability of going concern opinion is significant at the 95% confidence level. The variable coefficient of investor sentiment is negative and significant, which shows when investor sentiment is high, the probability of a Going Concern Opinion decreases. The results of the Hosmer-Lemeshow test show that the model has a good fit. The prediction accuracy percentage of the model is 93.67%.

Model 2 investigates the relationship between investor sentiment and the accuracy of the going concern opinion (type 1 error). As mentioned before, in this model, it is checked whether the companies that received a going concern opinion this year, the next year Are they bankrupt or not. Considering the use of two criteria for bankruptcy, in both sections, the model is significant at the 95% confidence level. The variable coefficient of investor sentiment is negative and significant, which shows that in periods with high sentiment, the auditor's type 1 error increases. This article shows that in periods of high investor sentiment, the probability of future bankruptcy of companies that received a going concern opinion by auditors decreases. The results of the Hosmer-Lemeshow test in both parts indicate the good fit of the model. The accuracy percentage of model prediction in the first part is equal to 77.27% and in the second part is equal to 71.63%.

Model 2investigate the relationship between investor sentiment and the accuracy of going concern opinion (type II error) and examines whether the companies that went bankrupt in the following year received a going concern opinion in the current year or not. Considering the use of two criteria for bankruptcy, in both sections, the model is significant at the 95% confidence level. The variable coefficient of investor sentiment is negative and significant in the first part at the 90% confidence level and in the second part at the 95% confidence level, which shows that in periods with high sentiment, the auditor's type 2 error increases. This means that for companies that have gone bankrupt in the future period, the probability of issuing a going concern opinion in periods with high investor sentiment will decrease. The results of the Hosmer-Lemeshow test in both parts show that the model has a good fit. The accuracy percentage of model prediction in the first part is equal to 71.63% and in the second part, it is equal to 72.24%.

In the end, it will be checked whether the market reaction to the going concern opinion in periods with different investors' sentiments. Two time periods are used in this section. The findings show that in both periods, the negative reaction of the market after the publication of the audit report containing the going concern clause is significantly smaller in periods with high investor sentiment than in periods with low sentiment.

CONCLUSION

The background of the research shows that many studies have investigated the relationship between investors' sentiment and market participants, including investors, analysts, and managers. Considering the important leadership role of auditors in crediting financial reporting, this research studies the relationship between investors' sentiment and auditor's behavior regarding audit risk assessment. For this purpose, the relationship between sentiments and the possibility of the going concern opinion is studied. The results showed in high investor sentiment, the probability of going concern opinion decreases. Thus, the estimation of the audit risk by the auditors is reduced and this leads to a decrease in the going concern opinion. Second, the relationship between investor sentiment and the accuracy of the auditor's going concern opinion is studied. The findings show in high investor sentiment periods the first and second types of errors in the auditor's report increase. The increase in the second type of error proves that auditors underestimate the bankruptcy risk of their owners and apply less conservatism in reporting during periods when investor sentiment is high. In the end, the paper studied the market's reaction to the going concern opinion in high and low investor sentiment periods. finding confirms the previous parts of the research. This means that the market's negative reaction to the going concern opinion in periods with high sentiment is less than in periods with less investor sentiment. To measure the market reaction, the daily accumulated abnormal returns are used during two time periods, one day before to one day after the date of

publication of the audit report and one day before to four days after the date of publication of the audit report. In the end, results show in high investor sentiment periods, fewer lawsuits against the auditors cause a limited going concern opinion and the accuracy of the audit report decreases.

Keywords: Investor Sentiment, Going Concern Opinion, Going Concern Opinion Accuracy, Market Reaction.

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