THE EFFECT OF AUDIT FIRM MERGER ON MARKET REACTION: 
THE CASE OF HANAFIAH RASLAN MOHAMAD CLIENTS

ABSTRACT

The scholars in auditing clearly agreed in consensus that the larger the audit firms the higher the quality of the auditors. The quality stems from the quality works that the Big Four will provide to their clients and subsequently will affect to the wealth of their clients. However, prior empirical studies did not investigate the quality of a new merged audit firm, which assumed as a higher quality of auditor than before merging using the market reaction, despite the widespread empirical evidence of the investors’ reaction towards the downgraded auditors’ quality.

This study investigates the effect on stock prices of Hanafiah Raslan Mohamad (formerly merged with Arthur Andersen) clients surrounding the merger announcement event between Hanafiah Raslan Mohamad (HRM) and Ernst and Young (E&Y). The results provide empirical evidences that the merger announcement had a positive effect on market prices of HRM clients. This study provides insight as to auditing literature about the effect of large audit firm reputation on clients’ share prices.