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GOING CONCERN AUDIT REPORTING IN BOSNIA AND HERZEGOVINA

Abstract

Purpose: This paper deals with going concern audit reporting in Bosnia and Herzegovina. The research objectives are to determine whether, in conditions of increased economic uncertainty, auditors issue this type of audit report more frequently, whether the bankruptcy of a company can be predicted based on a going concern audit report, and whether companies that receive this type of audit report engage in audit opinion shopping.

Methodology: The research was conducted on a sample of audit reports of 187 companies referring to the period from 2017 to 2021. Content analysis method was used.

Results: The average rate of going concern audit reports was 19.2%. Observed by year, the rate of going concern audit reports ranges from 18.1% to 19.9%. All companies that received a going concern audit report in the considered period one or more times are still operating. In 17.5% of cases, companies replaced the auditor after receiving a going concern audit opinion, while in 16.4% of cases, companies replaced the auditor even though they did not receive a going concern audit opinion.

Conclusion: The increase in economic uncertainty during the coronavirus pandemic led to only a slight increase in the rate of going concern audit reports. This type of audit report cannot serve as a predictor of the company's bankruptcy. Companies that receive a going concern audit report do not engage in audit opinion shopping in order to avoid receiving the same type of audit report in the following year.

Keywords: Going concern audit report, going concern assumption, material uncertainty related to going concern

1. Introduction

Financial statements are the basic means by which management communicates information about the financial condition, profitability and cash flows of the company to owners and other external stakeholders. Financial statements should contain complete and reliable information about the financial effects of all company activities undertaken in one accounting period.

According to International Accounting Standard 1, financial statements are prepared using the going concern assumption. This assumption implies that the company will continue its operations for the foreseeable future and that it has the operational and financial capabilities to maintain business continuity (Simamora & Hendarjatno, 2019). This means that the company will be able to use its assets and meet its obligations through normal business operations. The going concern assumption cannot be applied if the management intends to liquidate or cease operations or has no alternative but to do so. "When the company's management is aware that there are significant uncertainties related to the events or the conditions that may cast doubt on the company's ability to continue operating indefinitely, the company is required to disclose any such uncertainty in its financial statements. When a company does not prepare financial statements on a going concern basis, it must disclose this fact, together with the basis on which the financial statements have been prepared, as well as the reason why the going concern assumption has not been met" (IASB, 2003).

The main purpose of auditing financial statements is to determine whether the information contained in financial statements is true and objective, i.e., whether financial statements are prepared in accordance with the applicable financial reporting framework. During the audit, the auditor is required, among other things, to assess the company's ability to operate for an unlimited period. The auditor should collect a sufficient volume of adequate audit evidence on the basis of which they will conclude whether the management's use of the going concern assumption in the preparation of financial statements is appropriate. Furthermore, based on the collected evidence, the auditor should conclude whether there is uncertainty regarding the company's ability to continue as a going concern.

If the financial statements are prepared using the going concern assumption and the auditor considers that the use of this assumption is not appropriate, they will express an adverse opinion. If the auditor concludes that there is significant doubt about the company's ability to continue as a going concern, but that the application of the going concern assumption is appropriate, the auditor will assess whether the financial statements disclose any material uncertainty related to events or circumstances that give rise to significant doubts about the company's ability to continue as a going concern, and whether these events or circumstances are adequately described. If the financial statements include the required disclosures, the auditor will express an unqualified opinion and include in the auditor's report a separate paragraph under the subtitle "Material Uncertainty Related to Going Concern" (MURGC), in which they will state that there are events or circumstances that indicate the existence of significant uncertainty that may cause significant doubt about the company's ability to continue as a going concern, and also draw attention to the notes in the financial statements describing these matters and state that the auditor's opinion has not been modified in relation to that matter. If the financial statements do not include appropriate disclosures about material uncertainty, the auditor will express a qualified opinion or an adverse opinion, as appropriate (IAASB, 2015).

An audit opinion given by an auditor in conditions where there is significant doubt about the company's ability to continue as a going concern one year after the date of the financial statement is called a going concern audit opinion. A going concern audit opinion means an unqualified audit opinion with an emphasis of matter for the existence of material uncertainty related to going concern, i.e., with the MURGC paragraph, and a modified audit opinion where the existence of the specified uncertainty is a reason for modifying the audit opinion. An audit report that contains this type of audit opinion is called a going concern audit report.

The subject of this paper is going concern audit reporting in Bosnia and Herzegovina. The research objectives are to determine the frequency of issuing a going concern audit report, whether, in conditions of increased economic uncertainty, auditors issue this type of audit report more frequently, whether the bankruptcy of a company can be predicted based on a going concern audit report, and whether companies that receive this type of audit report engage in audit opinion shopping. The paper is organized as follows. The second section provides an overview of previous research on a going concern audit opinion. Research design is presented in the third section. The research results are presented in the fourth section. Concluding considerations are given in the fifth section.

2. *Theoretical and conceptual background*

In the audit literature, the going concern audit opinion has been investigated from different aspects. The identified research areas relate to determining the frequency of issuing a going concern audit opinion, identifying the factors that influence the issuance of this type of audit opinion, developing a model that will help auditors to give the most appropriate audit opinion in circumstances when there is doubt about a company's ability to continue as a going concern, and examining the impact of the going concern audit opinion on the behavior of participants in the financial market.

Cheffers et al. (2010) investigated the frequency of issuing a going concern audit opinion on a population of audit reports submitted to the US Securities and Exchange Commission between 2000 and 2009. They determined that the rate of issuing going concern audit opinions among US companies ranged from 14.4% in 2003 to 20.3% in 2008. This research showed that the frequency of issuing going concern audit opinions increased significantly during and after the global financial crisis in 2007 and 2008 compared to the period before this crisis. This means that auditors express a going concern audit opinion more frequently in a period of increased economic uncertainty. Xu et al. (2011) reached the same conclusion. They investigated the frequency of issuing different types of audit opinions in Australia in the period from 2005 to 2009. They conducted the research on a sample of 8,382 Australian listed companies, which is approximately 95% of the total number of companies listed on the Australian stock exchange during that period. The results of their research showed that the frequency of issuing going concern audit opinions increased significantly during and after the global financial crisis, from 12% in the period from 2005 to 2007, to 18% and 22% in 2008 and in 2009, respectively. The lack of credit liquidity and a decrease in economic activity during the global financial crisis significantly increased business risk, which led to an increase in uncertainty regarding the ability of companies to continue as a going concern, which was reflected in audit reports. Circumstances that led the auditors to express doubts about the ability of companies to continue as a going concern relate to the fact that the companies were making a loss or a negative operating net cash flow, that they were not able to settle their obligations on the due date, and that they had limited opportunities to obtain additional sources of financing.

Carson et al. (2016) also analyzed trends in audit reporting in Australian listed companies, covering the period from 2005 to 2013. The research was conducted on a sample of 15,855 audit reports. Their research showed that in the period from 2005 to 2007, the percentage of audit reports containing a going concern audit opinion was stable at a level of around 12%. Most of these reports contain an unqualified audit opinion with an emphasis of matter for the existence of material uncertainty related to going concern. In the period from 2008 to 2010, the percentage of audit reports relating to going concern increased to around 22%, which is a consequence of the impact of the global financial crisis on the operations of Australian companies. It is interesting to note the trend of increasing the percentage of going concern audit opinions in the period from 2011 to 2013, with a peak of 33.3% in 2013. The authors hypothesize that the increase in the frequency of going concern audit opinions in the period from 2011 to 2013 is a consequence of the impact of the slowdown in Chinese economic growth on the Australian economy and the increased scrutiny of auditors by regulatory authorities regarding the applicability of the going concern assumption. Carson et al. (2016) also found that a company that received a going concern audit opinion in one year is more likely to receive the same opinion in the following year. They also determined that the rate of companies that receive a going concern audit opinion and continue with business in the following year is at a level of 92% to 94%.

Carson et al. (2016) also found that Australian companies that receive a going concern audit opinion are not inclined to audit opinion shopping, that is, they do not replace the auditor in search of an auditor that will give them a more favorable audit opinion. Namely, the percentage of companies that received a going concern audit opinion and replaced the auditor in the following year is lower compared to companies that did not receive a going concern audit opinion, but replaced the auditor. This is in contrast to the results obtained by Chung et al. (2019). Based on a sample of 11,628 US financially distressed companies, covering the period from 2004 to 2012, they found that these companies successfully engage in audit opinion shopping in order to avoid a going concern audit opinion. The results of other research studies on this topic are not harmonized. For example, Carcello and Neal (2003) found that companies tend to replace auditors after receiving an unfavorable audit opinion. However, Krishnan (1994) and Krishnan and Stephens (1995) found that companies that replace the auditor after receiving an unfavorable audit opinion do not receive a more favorable audit opinion by the next auditor. This could mean that the replacement of the auditor is not related to audit opinion shopping or that audit opinion shopping has not been successfully realized because the next auditor does not agree to compromise their independence. In contrast to the research mentioned earlier, Lennox (2000) found evidence that companies successfully use audit opinion shopping.

Successful audit opinion shopping indicates a lack of independence of the auditor, which can affect audit quality. However, financially distressed companies may have a strong motive to engage in audit opinion shopping in order to avoid a going concern audit opinion because this type of audit opinion can have negative consequences for the company's operations. Menon and Williams (2010) found that institutional investors react negatively to the issuance of a going concern audit report. Namely, institutional investors react to the going concern auditor opinion by reducing their shares in the capital of the companies that have received this type of audit opinion, thus causing a drop in the stock price of these companies. This research has shown that the reaction of institutional investors is more negative if the inability of the company to settle its obligations on the due date and problems in obtaining additional sources of financing are cited as reasons for expressing doubts about the company's ability to continue as a going concern. Geiger and Kumas (2018) also determined that after the issuance of a going concern audit report, institutional investors increase the sale of stocks of the companies that received this type of audit report. Chen et al. (2016) determined that the going concern audit opinion also affects lending conditions. They compared the lending conditions in the year after the companies received a clean audit opinion and the lending conditions in the year after the companies received a going concern audit opinion. They found that in the year after the going concern audit report, creditors approve a smaller credit limit, with higher interest rates and most often with the collateral requirement.

And finally, we will mention the results of the research conducted by Vučković-Milutinović (2019). All aforementioned research studies were conducted on a sample of companies from developed countries. Vučković-Milutinović (2019) investigated the frequency of modified audit opinions, including going concern audit opinions, among listed companies in Serbia, which is a developing country, just like Bosnia and Herzegovina. The research was conducted on a sample of audit reports of 112 listed companies that were issued in the period from 2015 to 2017. This research showed that in the period from 2015 to 2017 the average rate of going concern audit reports was 21.4%. The highest rate was recorded in 2016, when 27% of companies received a going concern audit report. About 2% of audit reports contained an unqualified audit opinion with an emphasis of matter for the existence of material uncertainty related to going concern, approximately 10% of audit reports contained a modified audit opinion with an emphasis of matter for the existence of material uncertainty related to going concern, while in approximately 9% of audit reports, the existence of uncertainty related to going concern was the reason for modifying the audit opinion. Auditors most often expressed doubts about a company's ability to continue as a going concern due to factors such as operating at a loss, having current liabilities that exceeded current assets, carrying substantial debt, and violating credit obligations.

3. Research design

The research was conducted on a sample of companies from Bosnia and Herzegovina listed on the Banja Luka Stock Exchange. The initial sample consisted of all companies listed on the Banja Luka Stock Exchange. Securities on the Banja Luka Stock Exchange are included in the official stock market and the free market. At the time of data collection, there were 32 companies on the official stock market, while the securities of 422 companies were listed on the free market. This means that the initial sample consisted of 454 companies.

The research covered a five-year period, from 2017 to 2021. For 152 companies, audit reports were available for all five years under consideration. In the case of 302 companies, audit reports for one or more years were not available. It was decided to include the companies for which audit reports were available for three or more years of the period considered in the sample. The final sample included 187 listed companies, or 41.2% of the initial sample. A total of 886 audit reports were collected. The number of audit reports analyzed by year is given in Table 1.

Table 1 Distribution of audit reports analyzed in the period from 2017 to 2021

	2017	2018	2019	2020	2021
Number of companies in the sample	187	187	187	187	187
Number of missing audit reports	8	10	13	7	11
Number of available audit reports	179	177	174	180	176

Source: Author's calculation

Table 2 shows the structure of the sample according to the main industry sectors. As can be seen in Table 2, the sample includes companies from 17 different industry sectors. The most represented companies are those involved in water supply, sewerage, waste management and environmental remediation activities, followed by those that deal with the processing industry and those engaged in financial and insurance activities.

Table 2 The structure of the sample by main industry sectors

Main industry section		No. of companies	% of companies
A	Agriculture, forestry and fishing	8	4.3
B	Ore and stone extraction	4	2.1
C	Processing industry	28	15.0
D	Production and supply of electricity, gas, steam and air conditioning	14	7.5
E	Water supply, sewerage, waste management and environmental remediation activities	43	23.0
F	Construction	8	4.3
G	Wholesale and retail trade; repair of motor vehicles and motorcycles	14	7.5
H	Transportation and storage	11	5.9
I	Accommodation and food preparation and service activities	4	2.1
J	Information and communication	3	1.6
K	Financial and insurance activities	24	12.8
L	Real estate activities	11	5.9
M	Professional, scientific and technical activities	10	5.3
N	Administrative and support service activities	1	0.5
P	Education	1	0.5
Q	Health care and social work activities	1	0.5
R	Arts, entertainment and recreation	2	1.1
	Total	187	100.0

Source: Author's calculation

Table 3 shows the structure of the sample according to ownership. The sample includes both private and public enterprises, with a greater representation of private enterprises. Out of the total number of companies that make up the sample, 65.2% are privately owned, and 34.8% are publicly owned.

Table 3 The structure of the sample by ownership of companies

	No. of companies	% of companies
Private enterprises	122	65.2
Public enterprises	65	34.8
Total	187	100.0

Source: Author's calculation

All collected audit reports underwent content analysis. Content analysis was used according to Smith (2003). It is an approach to document and text analysis to quantify their content. This research method is commonly used in accounting research and has been employed by other authors investigating audit reporting (e.g. Carson et al., 2016; Vučković-Milutinović, 2019). Quantification is carried out within predefined categories and in a systematic and replicable manner. Content analysis was performed to determine whether the audit report contains a going concern audit opinion, which events and circumstances were cited as the reason for expressing doubt about the company's ability to continue as a going concern, and which audit firm performed the audit and issued an audit report.

4. Results

Table 4 shows the percentage share of going concern audit reports of listed companies in Bosnia and Herzegovina in the period from 2017 to 2021. Out of a total of 886 analyzed audit reports, 170 audit reports contain a going concern audit opinion. The average rate of going concern audit reports for the period from 2017 to 2021 is 19.2%. Observed by year, the rate of going concern audit reports ranges from 18.1% to 19.9%.

Table 4 Proportion of going concern audit reports in the period from 2017 to 2021

	2017	2018	2019	2020	2021	Total
Going concern audit reports	**19.0%**	**18.1%**	**19.0%**	**19.9%**	**19.9%**	**19.2%**
Unqualified audit opinion with MURGC paragraph	9.5%	10.2%	9.9%	9.4%	11.4%	10.1%
Modified audit opinion with MURGC paragraph	8.4%	6.8%	8.0%	9.4%	8.5%	8.2%
Modified audit opinion with modification on going concern	1.1%	1.1%	1.1%	1.1%	0.0%	0.9%
Other audit reports	**81.0%**	**81.9%**	**81.0%**	**80.1%**	**80.1%**	**80.8%**

Source: Author's calculation

When it comes to the structure of going concern audit reports, it can be noticed that in the majority of cases, auditors only emphasize the matter of material uncertainty related to the going concern. In less than 1% of cases, the existence of material uncertainty related to the going concern is a reason for modifying the audit opinion. On average, approximately 10% of audit reports contain an unqualified audit opinion with the MURGC paragraph, while approximately 8% of audit reports contain a modified audit opinion with the aforementioned paragraph. In the case of a modified audit opinion with the MURGC paragraph, the auditor draws the user's attention to the existence of significant doubt about the company's ability to continue as a going concern, while the reason for the modification of the audit opinion is something other than the existence of the aforementioned doubt.

Table 5 shows how often companies received a going concern audit opinion in the considered period. As can be seen in Table 5, 70% of companies never received a going concern audit opinion, while in almost 30% of companies, doubts about their ability to continue as a going concern were identified at least in one year. As many as 8% of companies received a going concern audit opinion four times in the period of five years, while in 5.3% of companies, material uncertainty related to going concern was identified in all five years.

Table 5 Repetition of the audit opinion on going concern in the period from 2017 to 2021

No. of received going concern audit reports	No. of companies	% of companies
Five	10	5.3
Four	15	8.0
Three	11	5,9
Two	7	3.7
One	13	7.0
Zero	131	70.1
Total	187	100.0

Source: Author's calculation

Out of the total number of companies that received a going concern audit opinion in 2017, 67.6% received the same opinion in 2018. In the following two years, this rate increased to 75%, while 80.6% of the total number of companies that received a going concern audit opinion in 2020 received the same opinion in 2021.

The question arises as to whether companies with identified events and circumstances that cast doubt on their ability to continue as a going concern manage to maintain business. This especially applies to companies that received a going concern audit opinion for several consecutive years. Based on the information contained in the Register of Business Entities, it was determined that all companies that received a going concern audit opinion once or more than once during the considered period are still operating.

Table 6 shows the circumstances that created significant doubt about the company's ability to continue as a going concern and led the auditors to issue a going concern audit opinion. Doubt about the company's ability to continue as a going concern can be generated by one or more events or circumstances.

Table 6 Circumstances which, individually or collectively, created significant doubts about the company's ability to continue as a going concern

Circumstances	No. of going concern auditor's reports	% of going concern auditor's reports
Net liability or net current liability position	135	79.4
The company made a loss	85	50.0
Loss is greater than equity	32	18.8
Adverse key financial ratios	22	12.9
The company does not perform its core activities or has significantly reduced the scope of its activities	18	10.6
Inability to pay creditors on due dates	16	9.4
The company achieved a negative operating cash flow	10	5.9

Source: Author's calculation

As can be seen in Table 6, the circumstances that led to doubts about the ability of companies to continue as a going concern are predominantly of financial nature. In the largest number of cases, almost 80%, it was about short-term liabilities being greater than current assets. This indicates existing or potential problems with the company's liquidity. The next most frequently mentioned circumstance is that the company made a loss. This is about the fact that the company made a loss in several consecutive periods and that the accumulated loss exceeds the amount of the variable part of own capital. In almost 19% of cases, the fact that the accumulated loss exceeds the amount of own capital is cited as the reason for doubting the company's ability to continue as a going concern. This means that the company's liabilities are greater than its assets and that the company makes a loss at the expense of creditors. In the case of bankruptcy, the company will probably not be able to pay off all the obligations to the creditors. Other circumstances refer to negative key financial indicators, most often indicators related to liquidity, then partial or complete cessation of the main activity, inability to settle obligations on the due date, and the realization of a negative net operating cash flow.

Some believe that after receiving a going concern audit opinion, companies replace the auditor in search of an auditor who will give them a more favorable audit opinion. Table 7 shows the percentage of companies that replaced the auditor after receiving the going concern audit opinion, as well as the percentage of companies that did not receive the going concern audit opinion and replaced the auditor. In 17.5% of cases, companies replaced the auditor after receiving a going concern audit opinion, while in 16.4% of cases, companies replaced the auditor even though they did not receive a going concern audit opinion.

Table 7 The tendency of companies to replace the auditor after receiving a certain type of audit opinion

	% of companies that replaced the auditor	**% of companies that did not replace the auditor**
Companies that received a going concern audit opinion	17.5	82.5
Companies that did not receive a going concern audit opinion	16.4	83.6

Source: Author's calculation

If companies in Bosnia and Herzegovina were inclined to audit opinion shopping, the percentage of companies that replace the auditor after receiving a going concern audit report should be much higher than the percentage of companies that replace the auditor even though they did not receive this type of audit opinion. It can be seen in Table 7 that this percentage is only slightly higher. This is insufficient to claim that there is a tendency of companies toward audit opinion shopping.

5. Discussion and conclusion

This research shows that the average rate of going concern audit reports in Bosnia and Herzegovina for the period from 2017 to 2021 was 19.2%, and that this rate, observed by year, was stable even though the considered period included two pandemic years. In 2020 and 2021, a significant number of companies were affected by the coronavirus pandemic. Due to the measures implemented to protect against the coronavirus, some companies had to temporarily suspend operations or significantly reduce the scope of their activities. Furthermore, in some industries, there was a significant drop in demand for products and services. All this led to an increase in business risk and business uncertainty. Previous research has shown that auditors are more likely to express a going concern audit opinion in a period of increased economic uncertainty (Cheffers et al., 2010; Xu et al., 2011), while this research shows that an increase in economic uncertainty leads to only a slight increase in the rate of going concern audit reports.

This research also showed that the majority of going concern audit reports contain an unqualified or modified audit opinion emphasizing the matter of material uncertainty regarding going concern, while in an extremely small number of audit reports the existence of material uncertainty regarding going concern was the reason to modify the audit opinion. Based on this, it can be concluded that in the majority of cases, companies have correctly reported on the existence of doubts about the company's ability to continue as a going concern and the events and circumstances that generate this doubt. However, based on the information available in the audit reports and the company's financial statements, it cannot be determined whether the companies included the required disclosures in their financial reports on their own initiative or did so at the auditor's request to avoid the auditor modifying the audit opinion. Circumstances that most often created significant doubts about the company's ability to continue as a going concern refer to the fact that the company's short-term liabilities are greater than its current assets, that the company makes a loss, and that the loss exceeds the amount of own capital.

Carson et al. (2016) determined that a large number of companies that receive a going concern audit opinion in one year receive the same opinion in the following year. This research reached the same conclusion. The rate of repetition of the going concern audit report in the considered period ranged from 67.6% to 80.6%. Out of the total number of companies included in the sample, in 13.3% of the companies, material uncertainty related to the going concern was identified in four or all five years. Despite this, all companies continue to operate, which means that the going concern audit opinion cannot serve as a predictor of company bankruptcy.

Although Chung et al. (2019) found that companies that receive a going concern audit opinion in one year replace their auditor in order to avoid receiving the same audit opinion in the following year and thus successfully implement the so-called audit opinion shopping, no evidence for this was found in this research. The reasons for replacing the auditor can be different. Companies that receive an unqualified audit opinion also replace the auditor, for objective or subjective reasons. The percentage of companies that received a going concern audit opinion and replaced the auditor is only slightly higher than the percentage of companies that did not receive this type of audit opinion, but still chose to replace the auditor. This is not enough to claim that companies replace the auditor to obtain a more favorable audit opinion. There is a possibility that companies in Bosnia and Herzegovina will not bear the negative consequences of obtaining a going concern audit opinion and therefore do not have to engage in audit opinion shopping.

When interpreting the results of this research, the limitations that existed in the research should be taken into account. In order to increase the sample, companies for which audit reports were not available for all years covered by the considered period were included in the sample. It is possible that companies did not submit audit reports containing an unfavorable audit opinion, including an audit opinion on going concern, to the Banja Luka Stock Exchange. The problem of missing data was particularly pronounced when determining whether the auditor had been replaced. The lack of an audit report for one year leads to the impossibility of determining whether there was a replacement of auditors in two consecutive years. Furthermore, when interpreting the research results, it should be borne in mind that issuing a going concern audit opinion does not depend only on the existence of circumstances that create significant doubt about the company's ability to continue as a going concern, but also on the quality of the audit. Namely, the issuance of a going concern audit opinion is influenced by the auditor's ability to identify circumstances that create significant doubt about the company's ability to continue as a going concern, as well as their willingness to request the disclosure of information about the existence of these circumstances or to modify the auditor's opinion if the audit client's management refuses to include the said disclosures in the financial statements. On the one hand, managers do not like to include unfavorable information in financial statements, and on the other hand, auditors may abandon their disclosure requirements or their intention to modify audit opinions in order not to lose a client.

Future research could focus on examining how users of financial statements react to the issuance of a going concern audit opinion and whether this type of audit opinion affects the decisions they make.

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