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ANALYSIS OF THE OPINIONS IN THE AUDIT REPORTS OF COMPANIES IN THE HOSPITALITY SECTOR: ACCOMMODATION AND CATERING SERVICE

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Abstract

Audit reports are a way of reassuring a user of financial statements, based on the auditor's opinion, on the truthfulness and objectivity of the financial statements. The research subject of this paper is the analysis of the opinions expressed in the audit reports of companies that belong to the service sector of accommodation and food, and within the context of the sectoral classification I-accommodation and catering, and are listed on the Belgrade Stock Exchange. The aim is to show the structure of audit opinions presented in the sector of accommodation and catering, in order to draw conclusions regarding the development of auditors' opinions. Also, based on the subject of research and analysis of the results, more research questions are opened regarding the future research directions and possibilities of perceiving the audit opinions development.

Keywords: *auditor's opinion, audit reports, accommodation and catering*
JEL classification: M42, L83

Introduction

Financial information is used to meet the needs of enterprises for decision-making, as well as for financial reporting purposes (Mitrović et al., 2015). Plant or internal calculation is not subject to the legal regulation, except for the information provided to financial accounting and therefore its organization and content are largely subordinate to the internal needs of enterprise management at different levels of the management structure (Knežević & Mitrović, 2015).

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The financial statements of companies represent the object of audit. According to the Audit Law (Official Gazette no. 62/2013), the audit is mandatory for regular annual financial statements of large and medium-sized legal entities classified in accordance with the law governing accounting, public companies in accordance with the law governing the capital market irrespective of their size, as well as of all legal entities, or entrepreneurs whose business turnover realized in the preceding business year exceeds EUR 4.400.000 in RSD equivalent (statutory audit). The criteria of classification of legal entities, according to the Accounting Law (Official Gazette No. 62/2013), according to which legal entities are classified into micro, small, medium and large, depending on the average number of employees, operating income and average value of the business assets established at the date of preparation of regular annual financial statement of the fiscal year, is shown in Table 1. The criteria for classification of companies according to the size are fulfilled if 2 out of 3 conditions are met.

Table 1: *Classification criteria of legal entities*

Criteria*	Micro	Small	Medium	Large
Average number of employees	up to 10	10 – 50	50-250	over 250
Operating income	up to EUR 700.000	EUR 700.000 - 8.800.000	EUR 8.800.000 – 35.000.000	over EUR 35.000.000
The average value of operating assets	up to EUR 350.000	EUR 350.000 - 4.400.000	EUR 4.400.000 - 17.500.000	over EUR 17.500.000

Source: *Made by the authors on the basis of the Accounting Law (Official Gazette No. 62/2013)*

The aim of the audit is to give an independent opinion on the accuracy of accounts of the company and thus provide assurance that the realized profit is reasonable, or "true and fair" through a review of the company performance (Mitrović & Knežević, 2016: 158).

In the audit of financial statements, the auditor checks the truthfulness and objectivity of the financial statements of the company. The audit of financial statements is a form of confirmation in which the auditor issues

a written report, which expresses an opinion on whether the financial statements contain material misstatements. Also, the audit of financial statements involves obtaining and evaluating evidence on financial operations of an entity, in order to determine the degree of implementation of legal regulations and accounting standards. The role of auditor in ensuring the quality of financial reporting is also in line with the opinion of the audit, which provides reasonable assurance that the financial statements are prepared in accordance with legal regulations (DeFond & Zhang, 2014).

The audit provides an objective assessment of whether the funds are responsibly and efficiently managed and reduces the risk in the relations between the interested parties (Knežević et al., 2016a). When we talk about the revision in the public sector, the audit may be viewed as³:

- *System audit*: analysis and evaluation of quality, adequacy, reliability and efficiency of the internal control mechanisms and procedures of the user of assets.
- *Financial audit*: analysis and evaluation of controls that ensure the accuracy and completeness of accounting data and financial statements.
- *Performance audit*: analysis and evaluation of the use and exploitation of resources in an economical, efficient and effective manner in order to achieve the objectives of beneficiaries of funds, as well as the evaluation of justifiability and appropriateness of these objectives.
- *Information technologies audit*: analysis and evaluation methods, procedures and use of electronic information systems related to safety, confidentiality, integrity and availability of information and information systems, as a means for achieving the objectives of the user of resources.
- *Compliance audit*: analysis and assessment of operational compliance of the user of the funds with laws, regulations, internal policies and provisions of the contract.

This paper presents theoretical explanations of audit reports, with a focus on practices used in the Republic of Serbia. In addition to theoretical

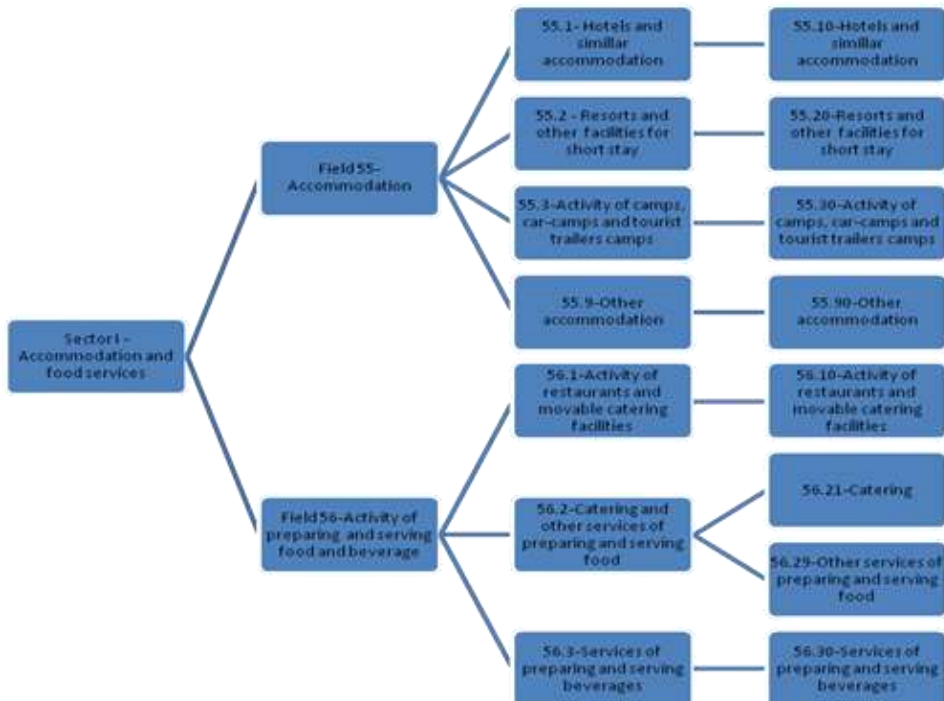
3 See: Pravilnik o zajedničkim kriterijumima za organizovanje i standardima i metodološkim uputstvima za postupanje interne revizije u javnom sektoru, "Službeni glasnik RS", br. 82/07, 99/2011. (http://demo.paragraf.rs/combined/Old/t/t2013_12/t12_0133.htm)

postulates, the paper analyzes the opinions of audit reports from the hospitality sector companies belonging to the sector of accommodation and food service, and in the context of the sectoral classification I- accommodation and catering, and which are listed on the Belgrade Stock Exchange.

The classification of activities (Statistical Office of the Republic of Serbia) defines the sectors, fields, branches and fields of activities with the industry codes. The sector I- Accommodation and food service includes the provision of accommodation services for short-stay of visitors and other travelers, as well as the preparation of complete meals and drinks for immediate consumption. This sector does not include accommodation for a longer period, in the capacity of the base of residence, as well as the preparation of food and beverages which are not intended for direct consumption or are sold through independent distribution channels, i.e. through wholesale or retail trade. Section I includes areas 55-Accommodation and 56-Activity of preparing and serving food and beverage, which in turn include multiple branches and groups, as shown in Figure 1.

The area of accommodation includes services of accommodation for short-stay of visitors and other travelers, as well as providing accommodation services for a longer period to students, pupils, workers and others. Some accommodation units may provide only accommodation while other provide a combination of services for accommodation, meals and/or recreational services. The field of activity of preparing and serving food and beverages includes the preparation of complete meals and drinks for consumption on site, either in a traditional restaurants, self-service restaurants or restaurant with “take away” service, in a permanent or movable kiosks, with seats or without them (see: Statistical Office of the Republic of Serbia, <http://webzrzs.stat.gov.rs/WebSite/userFiles/file/Klasifikacija%20delatnosti/Klasifikacija.pdf> (accessed on 30.01.2017))

Figure 1: *Display of areas, branches and groups of sector I- accommodation and food services*



Source: *Made by the author based on: The Republic Institute for Statistics, <http://webzrzs.stat.gov.rs/WebSite/userFiles/file/Klasifikacija%20delatnosti/Klasifikacija.pdf> (accessed on 30.01.2017)*

The audit reports of companies

The users of accounting information are, in addition to management at all levels in the company, also a number of external users, due to the successful implementation of management activities. The external users are primarily interested in the financial statements in the company (Mitrović & Vučić, 2015).

Audit reports are the most common and the highest level of assurance provided by independent auditors to interested users of financial information of the company. The audit report is often the only formal way of communication with interested users on the basis of which they can draw conclusions regarding the financial statements of the company. The preparation of the audit report is the final phase of the audit process, and to fulfill all the obligations, auditors must thoroughly know the

International Standards on Auditing - ISA. On the basis of the whole process of the audit, the audit report includes the auditor's opinion on the financial statements in all material aspects. When viewed with a greater detail the essence of certain financial statements for the balance sheet we can say that the information are shown on the date of the sheet, income statement contains many non-cash transactions, whereas cash flow statement records the changes in other financial statements during the period and focuses on cash available for business operations and investments (Knežević et al., 2016b).

In the auditing procedure, the auditor obtains a letter/statement of management that gives credibility to financial statements prepared by the management, in terms of truthfulness and legality of the presentation of the financial position, results of operations, changes in capital and financial flows, as well as in terms of providing accurate accounting records based on which these financial statements are prepared.

According to the Audit Law (Official Gazette no. 62/2013) audit report is compiled in accordance with ISA and contains at least the following elements:

1. the introduction which specifies the financial statements that are the subject of audit, together with the accounting policies that are used for their preparation;
2. the description of the purpose and scope of the audit, with reference to auditing standards in accordance with which the audit is conducted;
3. the opinion of a licensed certified auditor which clearly expresses whether the financial statements give a true and fair view of the financial position of the legal entity in accordance with the relevant legal framework, as well as whether the annual financial statements are in accordance with special regulations governing the operations of the legal entity, if provided for by those regulations. The auditor's opinion can be unqualified, qualified, adverse or the certified auditor may refrain from expressing an opinion if he/she is not able to express it;
4. Special alerts and problems that the licensed certified auditor wishes to draw attention to, but without expressing a qualified opinion;
5. an opinion on the compliance of the report on operations with financial statements for the same business year.

When we talk about the kinds of opinions, it should be noted that the auditor's opinion can be unmodified or modified. Accordingly, when

considering the auditor's judgment about the nature of the issues that lead to a modified opinion, we can talk about whether the financial statements contain false statements or about the inability of the auditor to collect sufficient appropriate evidence as well as about the auditor's judgment about the effect or potential effect on the financial statements, in the sense of material and pervasive or material, but not pervasive effects (Table 2).

Table 2: *The auditor's judgment about the nature of the issues that lead to a modified opinion*

The nature of the issues leading to a modified opinion	The auditor's judgment about the effect or potential effect on the financial statements	
	Material but not pervasive	Material and pervasive
The financial statements contain false statements	Qualified opinion	Adverse opinion
The inability of the auditor of collecting sufficient appropriate evidence	Qualified opinion	Disclaimer of opinion

Source: *Todorović, M. & Vučković, Milutinović S. (2015), Revizija, Centar za izdavačku delatnost ekonomskog fakulteta u Beogradu, Ekonomski fakultet u Beogradu, Beograd. p.341.*

According to Soltani (2007, p.368), the independent auditor's report can take various forms under different conditions. The auditor's report may be:

- a standard report that contains an unqualified opinion;
- a report that contains an unqualified opinion with added explanatory paragraph; or
- a report that expresses one of three other types of opinion – qualified, adverse or disclaimer.

Under ISA 700 (IFAC, 2005) an auditor may not be able to express an unqualified opinion when either of the following circumstances exist and, in the auditor's judgment, the effect of the matter is, or may be, material to the financial statements:

- there is a limitation on the scope of the auditor's work; or
- there is a disagreement with management regarding the acceptability of the accounting policies selected, the method of their application or the adequacy of financial statement disclosures;

- there is a lack of independence, and in this case the auditor must disclaim an opinion on the financial statements.

Recently the credibility of top managers and auditors has been increasingly examined, as a result a large number of accounting scandals, such as: *Enron*, *Worldcom* and *Parmalat*. Surprisingly the above-mentioned companies by the time of the collapse had unqualified opinion of the auditor. This fact points to the renewal of the open question concerning the quality of financial reporting and performance of auditing firms, to ensure accuracy and completeness of the financial statements. Prompted by the foregoing, researchers and professional institutions have increasingly focused their research to the auditor performance in terms of quality (Tritschler, 2013).

Analysis of opinions from the audit reports of companies from the hospitality sector: accommodation and food services

For research purposes of the modalities of audit opinions in this paper, we a total of 40 companies were analyzed within category I-accommodation and food services, and whose shares are listed on the BSE. For the analysis, the official data of the Agency for business registers and audit reports for the year 2014 and 2015 were used.

Considering that the Audit Law recognizes several types of audit opinions as follows: Unqualified, qualified opinion, adverse or a certified auditor may refrain from expressing an opinion if he/she is not able to express it, and that it is a common practice in the Republic of Serbia to express an unqualified opinion with drawing attention, it can be concluded that this shows special warnings and problems that licensed certified auditor wishes to draw attention to, but without expressing qualified opinion, and it will be a special object of observation.

Shown below are the examples of different opinions (unqualified, unqualified opinion with drawing attention, qualified opinion, disclaimer of opinion and adverse opinion) presented in the audit reports of companies belonging to the sector of accommodation and food service in 2014 or 2015.

An example of *unqualified opinion* shown in the audit report of the company which belongs to the sector of accommodation and food service for the year 2015:

According to the auditors' opinion, the financial statements present true and objective, in all material respects, the financial position of the company as at 31st December 2015 as well as the results of its operations and its cash flows for the year ended on that date, in accordance with International accounting standards, International financial reporting standards and the accounting regulations of the Republic of Serbia. (Source: Agency for the business registers, <http://www.apr.gov.rs/> (accessed on 07.02.2017))

An example of *unqualified opinion with drawing attention* shown in the audit report of the company which belongs to the sector of accommodation and food service for the year 2015:

As part of the audit opinion for the year ending on 31st December 2015, it was pointed out that the short-term liabilities exceeded current assets of the company, while cash outflows from total activities were higher than inflows on the same basis. Previously shown circumstances indicate the existence of a material uncertainty which may cast significant doubt about the ability of the company to continue to operate in accordance with the principle of continuity of operations. It is further noted that the financial statements do not include any eventual adjustments that might result from the removal of that uncertainty and that the auditor's opinion is not modified in relation to the above issue. (Source: Agency for the business registers, <http://www.apr.gov.rs/> (accessed on 07.02.2017))

An example of *qualified opinion* shown in the audit report of the company which belongs to the sector of accommodation and food service for the year 2014:

It shows the basis for the qualified opinion, in which, among other things, it is pointed out that the collectability of receivables was performed to the day of the audit and it was concluded that the collectability is highly difficult and jeopardizes the liquidity of the company. Also, the collectability of receivables in the country over a year is quite uncertain and it has substantial materiality to the financial result, and it was pointed out that the current account was also in the blockade all the time in 2014.

According to the auditor's opinion, except for the effects of the matters set forth in part the basis for the qualified opinion, the financial statements present truthful and objective, in all material respects, the financial position of the company as at 31st December 2014 and the results of its operations and cash flows for the year ending on that date, in accordance with the regulations of the Republic of Serbia. (Source: Agency for the business registers, <http://www.apr.gov.rs/> (accessed on 07.02.2017))

An example *disclaimer of opinion* shown in the audit report of the company which belongs to the sector of accommodation and food service for the year 2015:

As part of the basis for disclaimer of opinion, it is stated that the auditors did not attend the annual inventory of the assets and liabilities of the company, because their engagement ensued after the date of the inventory, and were not able to take alternative audit procedures to assure into the reported amount, value and condition of assets and liabilities at the balance sheet date, due to the nature of accounting records. In this regard, they pointed out that they were not able to assure themselves that the recognition and valuation of property, plant and equipment was carried out in accordance with IAS 16 - Property, plant and equipment, nor assure themselves into the changes and possible impairment of assets. Due to the limitations arising from the nature of the accounting records they were not also able to assure in the recognition and valuation of accounts receivable. The company's business account is blocked and the company is servicing its obligations with difficulty, so that there is the possibility of calculating the default interest, i.e. launching litigations by the creditors. In the auditing there was no possibility for auditors to carry out independent confirmation of the liabilities, and based on the analysis settling the liabilities it was observed that the company is not settling regularly its obligations, that there is delay in settling the obligations, and on this basis there is a potential possibility of calculating the default interest, as well as launching litigations. Accordingly, the auditor should modify the auditor's report by adding a paragraph to highlight a material matter regarding a going concern problem, and the auditors examined whether the financial statements are prepared under the assumption of maintaining the principle of business continuity (*Going Concern principle*). The loss was stated higher than the amount of capital and short-term liabilities of the company exceed the total current assets, and thus recommendations were highlighted in the sense that it is necessary that the company obtains additional net working capital to freely be able to continue its operations in accordance with the principle of continuity.

Due to the significance of the matters described in the parts showing the basis for disclaimer of opinion, the auditors were unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion, and thus they do not express an opinion on the financial statements. (Source: Agency for the business registers, <http://www.apr.gov.rs/> (accessed on 07.02.2017))

According to Soltani (2007), a disclaimer of opinion should be expressed when the possible effect of a limitation on scope is so material and pervasive that the auditor has not been able to obtain sufficient appropriate audit evidence and accordingly is unable to express an opinion on the financial statements.

An example *adverse opinion* shown in the audit report of the company which belongs to the sector of accommodation and food service for the year 2015:

The review of basis of expressed adverse opinion includes a statement of auditors that the company performed the estimation of the fair values of property and equipment and increased the value of property and equipment by correcting the values of property and equipment, therewith keeping the depreciation rate for the properties and consequently increasing the useful life, while at the same time the assessor did not establish the estimated useful lives of property and equipment at the date of assessment. Also, with an insight into the court cases it was found that the company conducts litigation regarding ownership of property, and the fact that these properties are not owned by the company, and there was no possibility of obtaining sufficient appropriate evidence so that the auditors could undoubtedly assure that the company is the undisputed owner of the property of the dispute. In the auditing process the basis of recognition of the value of land was not documented, and by examining the possession lists of land it was found that the company did not perform the conversion of rights of use to the rights of ownership, and thus the audit was unable to determine the exact amount of correction that may arise on the basis, or their the impact on the financial statements for 2015. The control of confirmation and collectibility was performed, the analysis of age structure of claims and placement, as well as debtor creditworthiness, when the presence of a low collection rate, insufficient confirmation and obsolescence of the claims was determined and that the associated company was constantly blocked from 2013. The foregoing has led the auditors being unable to assure themselves as to the adequacy of balanced amount of the claims, nor to quantify the effect that the corrections based on the write-off of receivables could have on the financial statements for 2015.

Also performed was the analysis of compliance, settling and age structure of liabilities and it was found that the company payables did not balance in accordance with the probable outflow of resources, and the auditors were unable to quantify the effects of potential corrections thereof on the financial statements for the year 2015. The company reported a loss,

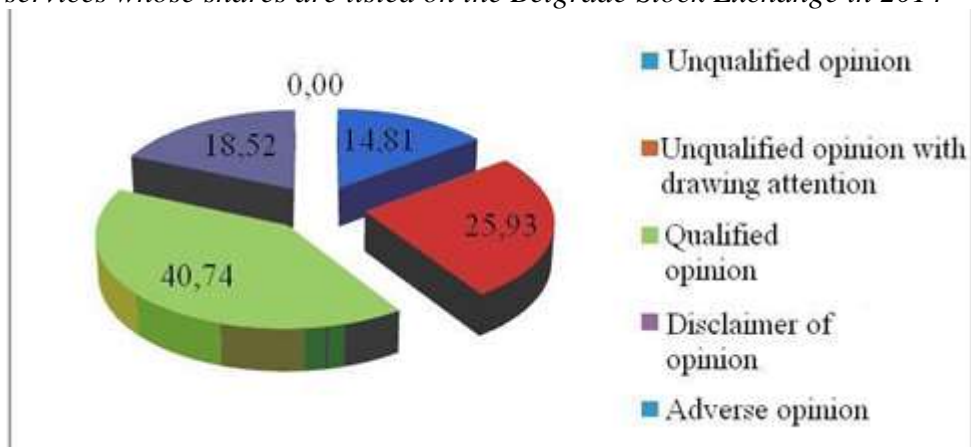
current liabilities exceed its current assets, current account of the company is blocked, and these facts point to the existence of doubt as to the ability of the company to continue its operations in accordance with the principle of business continuity, if it does not obtain additional capital or net working capital resources.

Due to the importance of the issues presented in the parts of the adverse opinion, the auditors point out that the financial statements do not present truthfully and objectively, in all material respects, the financial position of the company as at 31st December 2015, nor the results of its operations and its cash flows for the year ending on that date, in accordance with the accounting regulations of the Republic of Serbia. (Source: Agency for the business registers, <http://www.apr.gov.rs/> (accessed on 07.02.2017))

According to Soltani (2007), an adverse opinion is used only when the auditor believes that the overall financial statements are so materially misstated or misleading that they do not present fairly an entity's financial position, results of operations, or cash flows in conformity with generally accepted accounting principles.

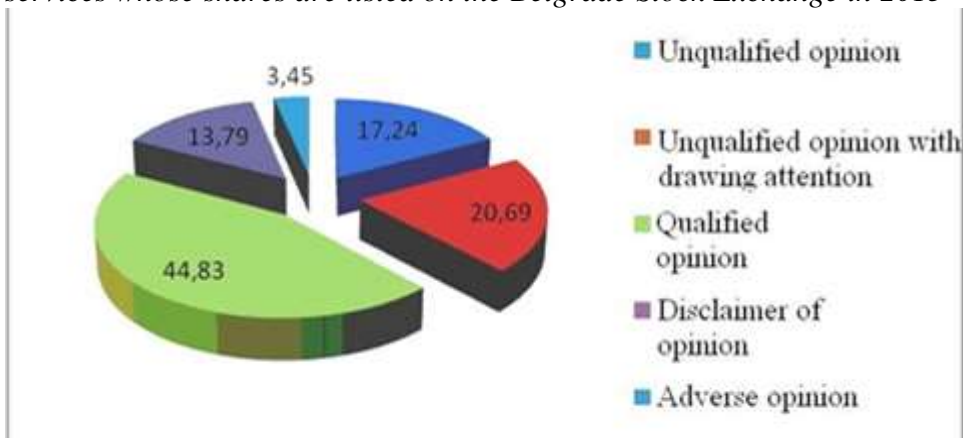
For 2014 a total of 27 audit reports of companies that were available on the website of the Agency for Business Registers were analyzed. Based on consideration of the opinions expressed, the largest share of opinions on the companies classified in the sector I-accommodation and food services whose shares are listed on the Belgrade Stock Exchange in 2014, is given in the context of the unqualified opinion (40.74%), there were no adverse opinions expressed (Graph 1). In 2014, 25.93% expressed the unqualified opinion with drawing attention, 14.81% unqualified opinion, and 18.52% disclaimer of opinion.

Graph 1: *Analysis of the opinions presented in the audit reports of companies classified within the sector I-accommodation and food services whose shares are listed on the Belgrade Stock Exchange in 2014*



Source: *Made by the author according to the audit reports (the Agency for Business Registers, <http://www.apr.gov.rs/>)*

Graph 2: *Analysis of the opinions presented in the audit reports of companies classified within the sector I-accommodation and food services whose shares are listed on the Belgrade Stock Exchange in 2015*



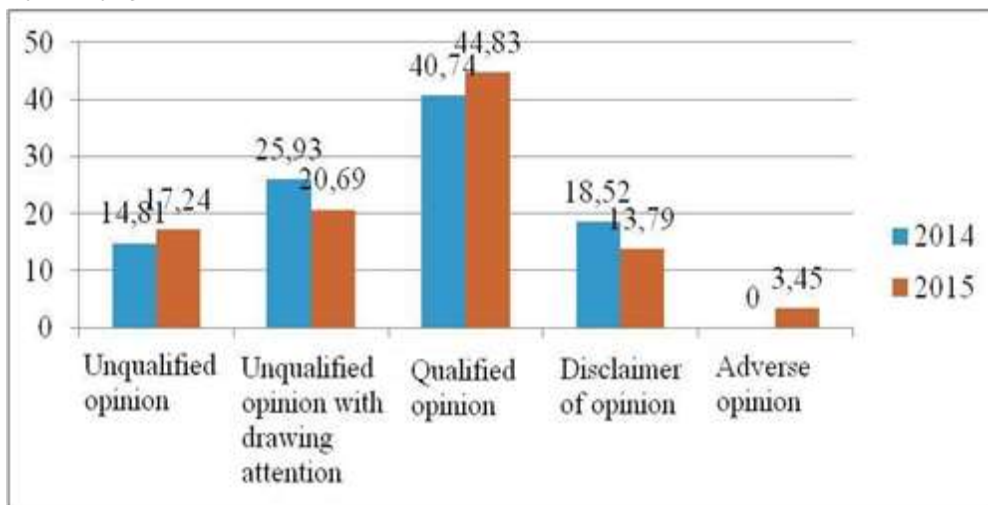
Source: *Made by the author according to the audit reports (the Agency for Business Registers, <http://www.apr.gov.rs/>)*

A total of 29 audit reports of the companies for 2015 that were available on the website of the Agency for Business Registers were analyzed. In the structure of totally considered opinions, the largest share of opinions on the companies classified in the sector I-accommodation and food services whose shares are listed on the Belgrade Stock Exchange in 2015, is given

in the context of the qualified opinion (44.83%) (Graph 2). In 2015, 3.45% expressed adverse opinions (1 company), 17.24% unqualified opinions, 20.69% unqualified opinions with drawing attention and 13.79% disclaimers of opinion.

Considered below is the movement of opinions presented in the audit reports of companies from the catering sector classified in the sector I-accommodation and food services, whose shares are listed on the Belgrade Stock Exchange from 2014 to 2015 (Graph 3). We can see that there has been an increase in the expressed unqualified opinions, qualified opinions and adverse opinions, and a reduction of unqualified opinions with drawing attention and disclaimers of opinion.

Graph 3: *The movement of opinions presented in the audit reports of companies classified within the sector I-accommodation and food services whose shares are listed on the Belgrade Stock Exchange from 2014-2015*



Source: *Made by the author according to the audit reports (the Agency for Business Registers, <http://www.apr.gov.rs/>)*

Conclusion

Audit reports provide the possibility of assuring the user in veracity and objectivity of the financial statement. Despite the advantages of audit reports, reflected in assuring the users in the veracity of financial statements, or confirming that the financial statements are prepared in accordance with standards and legislation, they should not constitute the

sole and absolute indicator of assurance that the financial statements are true and fair.

This raises an issue of the development of the audit profession and the level of customer trust in the veracity and objectivity of audit reports. Thus one can speak about several important issues that have been initiated by the previous issue, and one of them is definitely the auditor independence and respect of ethical principles in all phases of the audit.

Despite the above issues deserving a deeper elaboration for a new research, audit reports, which in addition to other required parts, contain as obligatory the auditor's opinion, can help users when deciding on many issues. In the Republic of Serbia, the auditor reports are quite standardized, with parts that are quite uniform, except to indicate some specific issues identified in the audit, in particular in the parts in which the auditor draws attention to certain observed specific issues. This raises several questions, one of which is whether considerable standardization and uniformity of audit reports provides an opportunity for interested users to view all the specific activities of the company, based on financial reports, for which accuracy and objectivity they are interested in. Also, one might raise the issue of detailed presentation and explanations of the observed specificity during the audit, and whether the scope of the information obtained by the auditor is sufficient for the company in which the audit was performed, as well as for interested users.

The analysis of audit reports, specifically expressed audit opinions, covered a total of 40 companies from the catering sector in the sector I-accommodation and food services, whose shares are listed on the BSE. In the period from 2014 to 2015, it has been observed that there has been an increase in expressing unqualified opinions, qualified and adverse opinions, and a reduction of unqualified opinions with drawing attention and disclaimers of opinion. The aforementioned may lead to the conclusion that parts of the audit reports expressed through the drawing attention by the auditors, expressed in 2014, led to a reduction in drawing attention in 2015, and consequently, an increase in unqualified opinions without drawing attention by the auditor. Also, a good indicator is the reduction of the stated disclaimers of opinions in 2015, compared to 2014. The question arises on the increase of the qualified opinions and one stated adverse opinion in 2015, compared to 2014.

With the aforementioned open issues, the basis is created for further research based on the object of this paper, and through a number of specificities of audit reports of companies in the sector I-accommodation and food services, but also of the opportunities for expansion of the analyzed companies sample, and the samples in multiple sectors and coverage of all companies in which the external audit is required.

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