

MODIFIED AUDIT OPINION AND EARNINGS MANAGEMENT IN STATE-OWNED COMPANIES: EVIDENCE FROM SERBIA

UDC 657.6+005]: 658.115(497.11)

Milica Đorđević¹, Dejan Spasić^{1,2}

¹University of Niš, Faculty of Economics, Niš, Republic of Serbia

²University of Belgrade, Faculty of Economics, Belgrade, Republic of Serbia

ORCID iD: Milica Đorđević
Dejan Spasić

 <https://orcid.org/0000-0003-1652-4186>
 <https://orcid.org/0000-0002-8540-579X>

Abstract. *The aim of the author of this paper is to examine the relationship between Earning Management (EM) and modified audit opinion among state-owned companies in the Republic of Serbia. The study sample consists of 64 state-owned companies whose financial statements were subject of audit by State Audit Institution in period 2018-2021. To detect EM, the financial statements of these companies for the four-year period 2018-2021 were used. The results of the study indicate that there is no positive relationship between EM and the auditor's modified opinion, i.e. that the difference in the distribution of the modified opinion in state-owned companies in which EM is identified and those in which EM is not identified is not statistically significant. These results initially point to the conclusion that auditors do not take EM into account when forming opinions, and do not send warning signals to users of financial statements. However, if one looks at the participation of the modified opinion on the financial statements of state-owned companies in which EM is identified, and especially the motive of EM, it can be said that the auditors of the State Audit Institution are adequately dedicated to this issue.*

Key words: *discretionary accruals, manipulations, qualified opinion, adverse opinion, disclaimer of opinion*

JEL Classification: H83, M41, M42

Received October 19, 2022 / Accepted November 25, 2022

Corresponding author: Milica Đorđević

University of Niš, Faculty of Economics, Trg kralja Aleksandra 11, 18000 Niš, Republic of Serbia

| E-mail: milica.djordjevic@eknfak.ni.ac.rs

1. INTRODUCTION

State-owned companies, with their important role in the provision of services of general interest, are often viewed as a tool for accelerated economic development and expansion, in strategically important economic activities. State-owned companies fulfill their obligation to provide information on financial position and business success through financial reporting. Financial statements, as the final product of financial reporting, contain a variety of useful information on the basis of which it is possible to evaluate previous and future achievements. As this information is crucial for decision-makers, its reliability and objectivity must not be questioned. In this regard, it is necessary to ensure high-quality financial reporting that will ensure social well-being as the supreme goal of society. Audit plays a significant role in increasing the credibility of information in financial statements, providing independent assurance of its truthfulness and fair presentation. The auditor's opinion based on objective evidence strengthens the financial accounting discipline and the responsibility of the ones preparing financial statements, thus laying the foundations of trust and mutual communication between State-owned companies and their stakeholders.

There is plenty of information in financial statements; however, "one of the most significant criteria for evaluating the performance and prospects of a business is earning measured by accounting" (Doan et al., 2021, 131). As state-owned companies are more than ever under pressure to increase their operational efficiency, improve their own and competitiveness of the economy as a whole, provide public services of higher quality at a lower price and responsibly use limited public funds, the auditors should pay special attention to earnings management (EM). EM implies active profit manipulation in order to make a changed impression of the company operations. EM is a "hot" topic because the management's tendency to show the company's performance as different from what it really is, by profit smoothing, is not rare. For this reason, auditors are expected to focus additionally on EM when performing their procedures and, in the case of its identification, send a clear signal to the users of the information in the form of a modified opinion. By modifying opinions, the auditor controls the work of managers and limits their opportunistic behavior (Barizah et al., 2005). Failure to disclose EM in financial statements of state-owned companies and issue an unmodified/positive opinion can have far-reaching negative consequences for the entire economy.

Examining the relationship between the auditor's modified opinion and EM in state-owned companies in the Republic of Serbia is primarily aimed at assessing the auditor's commitment to this issue. The auditor's modified opinion on financial statements in which profit manipulation is identified indicates the quality of the procedures they have implemented. As Akbaryan Fard et al. (2020) point out, audit quality is the auditor's ability to discover and report important distortions and discover manipulations in net income. This further significantly reduces EM (Imen & Anis, 2021), that is, as Othman & Zegnal (2006) point out, in case of high quality of audit, managers are not willing to perform manipulations through profit management.

The remainder of the paper is structured as follows. After this Introduction, the second section of the paper provides literature review on the basis of which hypotheses are defined. In the third section of the paper, the design of empirical research is presented. Results of research are presented and discussed in the fourth section, while the fifth section provides the conclusions.

2. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

EM practices were introduced in recent years, as a number of serious scandals occurred in some firms (like the collapse of Enron Company) that overstated profits to trick investors and users (Sharf & Nassar, 2021). Many authors have dealt with the definition of EM, so Ronen & Yaari (2008) argue that EM can be defined as the alteration of the firm's reported earnings by managers to either mislead external users of financial statements or to influence contractual outcomes. Healy & Wahlen (1999) indicate that "EM occurs when managers use judgment in financial reporting and in structuring transactions to alter financial reports to either mislead stakeholders about the underlying economic performance of the company or to influence contractual outcomes that depend on reported accounting numbers." Some authors focus on flexibility in accounting standards when defining this concept, so Dechow & Skinner (2000) define EM as the abuse of accounting techniques and principles, i.e. a legitimate practice or deliberate omission of material facts with the intention of deceiving users of accounting information. Also, Baralexis (2004) notes that "EM is the process of intentionally exploiting or violating the GAAP or the law to present financial statements to suit one's interest." Certainly, whichever approach is present in the definition, EM implies the management intervention to determine the amount of profit, i.e. showing a higher profit and a better balance sheet or showing a lower profit and a worse balance sheet, depending on the interest.

Although the EM concept is initially associated with private companies, the application of the accrual accounting basis in state-owned companies brought EM to the attention of many scholars in the field (Bisogno & Donatella, 2022). Also, the reason is that state-owned companies assume an arrangement in which the management characteristics of private and state-owned companies coexist, all in order to provide public services at a high level, and due to increased exposure to the capital market and tougher competition, state-owned companies must continuously improve their performance in order to survive on the market (Bonić & Đorđević, 2017). State-owned companies with poor results have a harder time accessing the capital market, which can additionally slow down their development, and for these reasons, management's tendency to hide profit, i.e. to abuse flexibility in financial reporting based on the choice of alternative accounting methods and estimates is not rare. Apart from this, Capalbo et al. (2018) highlight that "there are as many reasons to expect a positive relationship between the ownership of state-owned companies enterprises by political communities and EM as there are reasons to presume a negative one." "Arguments in favour of a positive relationship rely on: (a) the expectation of a relatively lower quality of corporate governance in state-owned companies, which is often linked to a greater degree of managerial discretion; (b) the greater heterogeneity of state-owned *accounttees*, which increases the potential addressees of state-owned companies and creates incentives for EM; (c) the fact that state-owned companies' economic and financial results impact a quantitatively and qualitatively unidentifiable group of subjects (the community acting as the residual owner), thus decreasing the expectation that reporting of those results will be monitored, as compared to the alternative hypothesis of readily-identifiable private investors" (Jones, 1991); and (d) the limited technical expertise of the addressees of state-owned companies reporting (Shleifer, 1998, Grossi & Thomasson, 2015, Bruton et al., 2015, Koh, 2003, in Ruggiero et al. 2022). Examinations of the presence of EM in state-owned companies are relatively recent and therefore limited. However, the results of the Ruggiero et al. (2022) research show that "managers of state-owned companies with higher

levels of public ownership are more likely to practice EM”, while Capalbo, (2014) also provides evidence that “EM by state-owned companies decreases with firm size and increases with profitability.”

The flexibility of International Financial Reporting Standards/International Accounting Standards and the possibility of choices between accounting policies and estimates have created a scope for applying different methods of earnings management. For these reasons, the question of whether financial statements are a reliable information base for business decision-making is quite justified. Audit should provide an answer to that question. “The objective of auditing financial statements is to allow the auditor to express an opinion as to whether the financial statements, on all material issues, have been prepared in accordance with the prepared financial reporting framework.” However, “audit opinion issued by an auditor not only indicates whether the organization is complying with accounting standards and is concerned about its financial management, but it is also an important factor for detecting and preventing fraudulent activities” (Bell & Zimmerman, 2007). The auditor's opinion can be: positive/unmodified and modified. Auditors express a positive opinion when they are convinced that the financial statements truthfully and honestly show the real state of affairs, profit, financial status, income, expenses, in accordance with accounting standards. However, when identifying EM the auditor is expected to express a modified opinion (Qualified Opinion, Adverse Opinion or Disclaimer of Opinion) and thus provide signals to the users of the information. Which type of modification “the auditor will apply is determined by the effect of ER on the truthfulness and objectivity of the financial statements” (in accordance with ISA 705). If the auditor assesses that the identified EM has a material but not pervasive effect on the financial statements he will express a qualified opinion. On the other hand, if the EM has a material and pervasive effect on the financial statements, and they contain misstatements, he will express a negative opinion. If, on the other hand, the auditors are unable to collect enough adequate evidence (which may be a consequence of concealment by the management due to the presence of EM), the auditors will express a qualified opinion if those limitations have a material but not pervasive effect, that is, they will abstain from giving an opinion if they have a material and pervasive effect on the financial statements.

As audit is seen as one of the main guardians of the truth and objectivity of financial statements, therefore “it is vital to examine the association between auditor’s opinion and EM in a situation where the propensity to manage earnings is high” (Tsipouridou1 & Spathis, 2014). The relationship between auditor opinion and EM is one of the most important issues among researchers in this field. To date, several studies have been conducted that deal with this relationship; however, the results show conflicting opinions.

Some authors claim that there is no positive correlation between EM and the auditor's modified opinion, that is, that the EM is negatively related to the qualified audit opinion. This group of authors includes: Tsipouridou & Spathis (2014) who “examined this relationship in companies listed on the Athens Stock Exchange”; Gajevszky (2014) in companies listed on the Bucharest Stock Exchange; Othman et al. (2017) in companies listed on the Bursa Malaysia which is classified as PN17, Garcia-Blandon et al. (2014) in companies in Spain, Veronika & Julisar (2020) in companies listed on the Indonesia Stock Exchange, Sharf & Nassar (2021) in companies listed in Amman Stock Exchange in Jordan, Imen & Anis (2021) in Tunisian firms listed on the Tunis Stock Exchange.

On the other hand, there are numerous research results that indicate the opposite, i.e. the existence of a positive correlation - the probability of expressing a modified audit

opinion and EM. Francis and Krishnan (1999) examined this relationship in listed companies in the United States; Doan et al. (2021) in Vietnamese listed companies on the Ho Chi Minh City Stock Exchange and Hanoi Stock Exchange; two studies: Moazedi & Khansalar (2016) and Abolverdi & Kheradmand (2017) “evaluate the effect of EM on type of auditor report in companies listed on Tehran Stock Exchange (TSE).”

Based on the above, the following hypotheses are developed:

- H1: There is a significant positive correlation between auditor's modified opinion and EM,
 H2: The auditor's modified opinion is represented to a greater extent than expected in state-owned companies in which EM has been identified, in contrast to state-owned companies in which it has not been identified.

3. METHODOLOGY

3.1. Sample selection and variables

For the purposes of testing the correlation between EM in state-owned companies in the Republic of Serbia and the auditor's modified opinion, state-owned companies whose financial statements were audited in the period from 2018 to 2021 were taken into account. The data was primarily collected from the 2018, 2019, 2020 and 2021 annual reports of the State Audit Institution, to identify that the financial statements of 73 state-owned companies were subject to audit. The same reports were the source of data on auditors' opinions on the financial statements of the mentioned companies. That is, to detect manipulative financial reporting., the financial statements of these companies for the four-year period 2018-2021, available on the Business Registers Agency website, were used. Since complete data were not available for nine state-owned companies, those companies were excluded from the research. After the implementation of the mentioned criteria, the final sample included 64 state-owned companies and a total of 264 financial statements for the purposes of EM calculation.

3.2. Selection and measurement of variables

In order to test the defined hypotheses, the auditor's opinion on the financial statements of state-owned companies represents a categorical variable. Bearing in mind that the auditor's opinion on financial statements can be unmodified/positive and modified (Qualified Opinion, Adverse Opinion or Disclaimer of Opinion), this variable has two values: 0 if the opinion is unmodified and 1 if the opinion is modified. Analysis of audit opinions on financial statements of state-owned companies by year and type is presented in Table 1.

Table 1 Audit opinions on financial statements of state-owned companies by year and type

Audit opinion type	2018		2019		2020		2021		Total	
Unmodified opinion	3	13.04%	2	16.67%	4	26.67%	1	7.14%	10	15.63%
Modified opinion:	20	86.96%	11	83.33%	11	73.33%	12	85.71%	54	82.81%
With exception/s	19	82.61%	9	75.00%	11	73.33%	12	85.71%	50	78.13%
Adverse	0	0%	2	16.67%	0	0%	0	0%	2	3.13%
Disclaimer of opinion	1	4.35%	0	0%	0	0%	1	7.14%	2	3.13%
Total audit opinions	23	100%	12	100%	15	100%	14	100%	64	100%

Source: Annual Activity Reports for 2018, 2019, 2020 and 2021.

EM defined as the second variable indicates manipulation in financial statements. Numerous models have been developed to calculate EM over time (Discretionary accruals models, Accruals quality models, Probit and logit models, etc.). However, auditors mostly use Discretionary accruals models, which imply the separation of the total accruals into a non-discretionary part, as economically determined accruals, and a discretionary part, as managerially determined accruals, because managers have discretion over the choice of accounting methods and estimates. For those reasons, Discretionary accruals (DA) is a measure of EM. If state-owned companies do not manipulate earnings, it is to be expected that the DA component will be zero. Otherwise, if the value of DA is significantly different from zero, it means that there is a practice of manipulating earnings in the observed period. At the same time, if the value has a positive sign, it means that earnings manipulation was carried out at a higher level, and on the contrary, if the value is negative, it means that the manipulation was carried out with the aim of presenting the financial result worse than it is.

According to a large number of conducted studies, the discretionary accruals models that are considered the most reliable are the Jones model (1991) and the modified Jones model (Dechow model (1995) and Kasznik model (1999)). For the purposes of DA in state-owned companies, we opted for Kasznik, a modified Jones model, which, in addition to possible income manipulation under the Jones model, also monitors changes in receivables from sales and changes in net cash flow from business activities. Kasznik model has the following form:

$$TA_{it}/A_{it-1} = \beta_0 * 1/A_{it-1} + \beta_1 * (\Delta REV_{it} - \Delta REC_{it}/A_{it-1}) + \beta_2 * (PPE_{it}/A_{it-1}) + \beta_3 * (\Delta CFO_{it}/A_{it-1}) + \varepsilon_{it} \quad (1)$$

Where:

TA_{it} - total accruals for the company i in the current period t ;

A_{it-1} - total assets for the company i in the previous year $t-1$

$\beta_0, \beta_1, \beta_2, \beta_3$ - estimated parameters or regression coefficients;

ε_{it} - residual variable or Discretionary accruals (DA)=Earnings management (EM)

ΔREV_{it} - change in net sales revenues of the company i in the current year t compared to the previous year $t-1$;

ΔREC_{it} - changes in net receivables from sales in the current year t compared to the previous year $t-1$

ΔCFO_{it} - change in net cash flow from operating activities in the current year t compared to the previous $t-1$

PPE_{it} - gross value of property, plant and equipment for the company i in the current year t

The DA procedure involves a three-phase approach:

First of all, TA_{it} is calculated using the cash approach, as follows:

$TA_{it} = NI_{it} - CFO_{it}$, where NI_{it} - net income for the company i in current year t .

In the second stage, the non-discretionary NDA_{it} follows. More precisely, as $TA_{it} = NDA_{it} + DA_{it}$, i.e. $TA_{it} = NDA_{it} + \varepsilon_{it}$, then using multiple linear regression analysis we get NDA_{it}

In the third stage, we get DA_{it} as follows:

$DA_{it} (\varepsilon_{it}) = TA_{it} - NDA_{it}$.

All variables in the model are divided by the value of total assets at the beginning of year A_{t-1} to mitigate potential heteroskedasticity.

After calculating the variables and initiating a multiple linear regression analysis, the values of the regression coefficients ($\beta_0, \beta_1, \beta_2, \beta_3$) were obtained, which gave the model of discretionary accruals for state-owned companies in the Republic of Serbia the following form:

$$\varepsilon_{it} = TA_{it}/A_{it-1} - ((-8309,77)/A_{it-1} + (-0,008) * (\Delta REV_{it} - \Delta REC_{it}/A_{it-1}) + -0,063 * (PPE_{it}/A_{it-1}) + 0,616 * (\Delta CFO_{it}/A_{it-1}) \quad (2)$$

This model was applied to a selected sample of state-owned companies in order to reveal the prevalence of earnings manipulation in financial statements. In order to test the claim about earnings manipulation in financial statements, i.e., to determine which state-owned companies' DA deviates statistically significantly from zero, a t-test was performed for each public company individually. By comparing the average DA value of each state-owned company with the expected value of this parameter (zero), we found that in 23 state-owned companies this deviation was statistically significant, that is, they manipulated income. At the same time, in 6 state-owned companies, DA had a negative sign, which indicates that in these companies the results were manipulated downwards, while in as many as 17 companies, this indicator had a positive sign, that is, in those companies, manipulation was performed in order to present income as better than it is.

For the purposes of connecting the EM and the auditor's opinion, DA takes the following values: 0 if manipulation is identified and 1 if manipulation is not identified.

3.3. Methods

As the research relates to the correlation between two categorical variables, the Chi-square test of independence will be applied in order to examine whether there is a statistically significant difference in the modified auditor's opinion in state-owned companies in which manipulation was identified and those in which it was not identified. Also, the Chi-square goodness of fit test will be used to test whether the observed distribution of modified opinion within State-owned companies where manipulation was identified corresponds to the one expected based on the structure of modified opinion for the total population.

4. EMPIRICAL RESULTS AND DISCUSSION

A Chi-square test of independence was applied to test the correlation between the auditor's modified opinion and EM. Table 2 summarizes the results of the distribution of auditors' opinions in state-owned companies of the Republic of Serbia in which manipulation was identified and those in which manipulation was not identified.

Table 2 Distribution of auditors' opinions in state-owned companies of the Republic of Serbia

		Manipulation			
		Exists	Does not exist	Total	
Audit Opinion	Modified	Count	22	32	54
		% within Audit Opinion	40.7%	59.3%	100.0%
		% within Manipulation	95.7%	78.0%	84.4%
			34.4%	50.0%	84.4%
	Unmodified	Count	1	9	10
		% within Audit Opinion	10.0%	90.0%	100.0%
		% within Manipulation	4.3%	22.0%	15.6%
		% of Total	1.6%	14.1%	15.6%
			23	41	64
		35.9%	64.1%	100.0%	

Source: Author's calculations based on data available in Annual Activity Reports for 2018, 2019, 2020 and 2021 of State Audit Institution and Financial Reports for 2018, 2019, 2020 and 2021 state-owned companies in sample

Chi-square test of independence (with continuity correction according to Yates') showed no significant correlation between observed variables, $X^2(1, N = 64) = 2.257$, $p = .133$, $\phi = .233$.

Table 3 shows the results of the Chi-square goodness of fit test of differences between the identified and expected distribution of modified opinion within state-owned companies where manipulation was identified and those where it was not.

Table 3 Observed and Expected Frequencies of Audit opinion by type and the existence of manipulation in financial statements

		Observed N	Expected N	Residual
Manipulation exists	Modified	22	19.1	2.9
	Unmodified	1	3.9	-2.9
Manipulation does not exist	Modified	32	34	-2.0
	Unmodified	9	7	2.0

Source: Author's calculations based on data available in Annual Activity Reports for 2018, 2019, 2020 and 2021 of State Audit Institution and Financial Reports for 2018, 2019, 2020 and 2021 state-owned companies in sample

Table 3 clearly shows that the observed modified auditor opinion on the financial statements of state-owned companies in which manipulation was identified (22 modified opinions) is higher than expected (19.1), established based on the previously set proportion, i.e. the opinion structure for the total population. Nevertheless, the result of the Chi-square goodness of fit test indicates that it is a very small difference that is not statistically significant ($X^2(1, N = 23) = 2.609$, $p = .106$).

The previous table also indicates that the observed modified auditor opinion is represented to a lesser extent (32) than expected (34) in state-owned companies in which manipulation in financial statements was not identified. However, even that difference is not considered statistically significant ($X^2(1, N = 41) = .712$, $p = .399$).

The presented results make it clear that none of the hypotheses about the correlation between EM and the modified auditor opinion have been confirmed. First, the distribution of modified opinion in state-owned companies in which manipulation was identified and in those in which it was not is not statistically significant. True, most of the auditor opinions on financial statements of state-owned companies in which manipulation was identified was modified (as many as 22 out of 23). However, the situation in terms of modified auditor opinion is no better for state-owned companies where manipulation was not confirmed - out of 41 auditor's opinions, 32 have been modified.

Also, although the modified auditor opinion in state-owned companies in which manipulation was identified is more prevalent than expected, and on the contrary, less prevalent than expected in state-owned companies in which manipulation was not identified, these differences are minor, i.e. they have no statistical significance.

The results obtained in this way on the sample of state-owned companies in the Republic of Serbia are consistent with the results of research by Tsipouridou & Spathis (2014), Gajevszky (2014), Othman (2017), Garcia-Blandon (2014) Spain, Veronika (2020), Sharf&Abu-Nassar (2021), Imen&Anis (2021) and point to the fact that there is no significant correlation between EM and the modified auditor opinion.

Since, according to many authors (Othman & Zeghal, 2006; Imen & Anis, 2021), audit quality is a significant factor in identifying EM, the obtained research results, at

first glance, point to a low level of auditor commitment to the issue of EM, that is, “auditors do not take into account the effect of EM when forming the audit opinion.” In this way, they are not even able to warn users of information from financial statements by modifying their opinion. However, if we analyze modified opinions in relation to non/identification of EM, the situation may change.

Table 4 presents the types of modified auditor opinion on financial statements of state-owned companies in which EM has been identified. As the table shows, as many as 22 state-owned companies in which EM was identified received a modified auditor opinion (which makes up 95.65% of the total of 23).

Table 4 Modification of Audit opinion in state-owned companies in which EM has been identified

Type of modified opinion	Number of state-owned companies with identified EM
With exception/s	19
Adverse	2
Disclaimer of opinion	1
Total	22

Source: Authors' calculation

Based on the analysis of the audit reports of these State-owned companies and especially the summary of detected irregularities and the stated basis for expressing a modified opinion, the auditors identified 20 State-owned companies that manipulated earnings by overestimating or underestimating income and expenses. Of those 20 State-owned companies, 17 were found to have manipulated revenues and expenses, which had a material but not pervasive effect on the financial statements, which is why those companies received a qualified auditor opinion on financial statements. In 2 state-owned companies, the manipulation had a material and pervasive effect on financial statements, which is why those companies received a negative opinion. In one company, the auditors were limited in gathering enough relevant audit evidence (which may be a consequence of concealment of evidence by the management due to manipulations), and the auditor abstained from issuing an opinion at that company. In the remaining 2 state-owned companies, the auditors failed to identify the manipulation of income and expenses, but based their qualified opinion on financial statements on non-up-to-date records and non-compliance of data with relevant state institutions.

Based on this analysis, it would be unrealistic to criticize the quality of the audit procedures implemented, because out of 23 state-owned companies where EM was identified, 22 received a modified opinion on the financial statements, while in one company the auditors made an omission.

On the other hand, if we looked at the 32 state-owned companies that received a modified opinion and the DA did not indicate that, then we could look for the answer in the EM category. More precisely, Ronen & Yaari (2008) “classify EM in three distinct groups:

- White EM (beneficial) enhances the transparency of reports,
- Gray – Managing reports within the boundaries of compliance with bright-line standards (gray), which could be either opportunistic or efficiency enhancing and
- Black – Black earnings management involves absolute misrepresentation. It assumes practices intended to misrepresent or reduce transparency in financial statements.”

Therefore, in 32 companies in which no EM was identified and which received a modified auditor's opinion on the financial statements, it is possible that the auditors identified the so-called Gray EM.

5. CONCLUSION

Earnings management assumes one of the strategies of financial result' manipulation, where the management tends to show a changed impression of the business by a legitimate choice of accounting procedures or a deliberate omission of material facts. Although it was initially associated with companies in the private sector, the concept of EM is increasingly discussed in the public sector as well. This is primarily in state-owned companies that use the accrual basis of accounting, which is also the case with state-owned companies in the Republic of Serbia. In addition, state-owned companies are increasingly exposed to competition, along with strict budget constraints and institutional and management changes, which results in the management's desire to make appropriate interventions in the financial reporting process in order to achieve some specific goal.

As EM seriously questions the truthfulness and reliability of information in financial reports, and auditing is one of the most important links in the supply chain of financial reporting quality, the question of the ability of auditors to recognize EM is increasingly highlighted. Users of information from financial statements expect the audit to adequately control the correct application of accounting standards, pre-defined accounting policies and procedures and, accordingly, to express their opinion on the objectivity and fairness of the financial statements, i.e. on whether they have been drawn up in accordance with all relevant issues with legal and professional regulations. In cases of identification of EM, auditors act in the public interest by modifying their opinion.

The purpose of the research conducted in the paper was to examine the relationship between the auditor's modified opinion and EM in state-owned companies in the Republic of Serbia. The obtained results did not support the hypothesis that there is a significant positive relationship between modified audit opinion and EM, nor that there is a statistically significant difference in the distribution of modified audit opinion in state-owned companies in which EM is identified and in those where it is not. Based on these results, one gets the first impression that auditors do not approach EM with due care. However, the distribution of the auditor's modified opinion in state-owned enterprises in which EM was identified and the analysis of the basis for the expression of the modified opinion in the entire population indicate the opposite.

The contribution of this paper is twofold. Furthermore, bearing in mind that the relationship between EM and modified audit opinion is one of the most important subjects of interest among researchers worldwide, it is of great importance to determine and present this relationship in state-owned companies in the Republic of Serbia. In this way, awareness will certainly be raised about the presence of EM in state-owned companies and, in particular, about the importance of auditing as a mechanism for preventing and detecting manipulations. Consequently, all this has the potential to influence the improvement of the quality of financial reporting of state-owned companies in the Republic of Serbia.

REFERENCES

- Abolverdi, Z., & Kheradmand, A. (2017). A Survey of the relationship between earnings management and qualified auditor opinion in Tehran stock exchange. *International Journal of Economics and Financial Issues*, 7(2), 723-729. <https://www.econjournals.com/index.php/ijefi/article/view/3862>
- Akbaryan Fard, M., Vakilifard, H., & Nikoumaram, H. (2020). The Impact of Audit Quality on Earnings Management: An Experimental Study with Evidence from IPO. *Advances in Mathematical Finance and Applications*, 5(3), 303-317. https://amfa.arak.iau.ir/article_666217.html
- Baralexis, S. (2004). Creative accounting in small advancing countries: The Greek case. *Managerial Auditing Journal*, 19(3), 440-461. <https://doi.org/10.1108/02686900410524427>
- Barizah, N., Baker, A., Rahim, A., Rahman, A., Rashid, A. (2005). Factors influencing – auditor independence. *Managerial Auditing Journal*, 20(8), 356–273. <https://doi.org/10.1108/02686900510619665>
- Bell, J., & Zimmerman, S. (2007). Absent the audit: How small nonprofits can demonstrate accountability without one. Retrieved from: <https://nonprofitquarterly.org/absent-the-audit-how-small-nonprofits-can-demonstrate-accountability-without-one/> Accessed on: 16 August 2022.
- Bešlić, I., Bešlić, D., Jakšić, D., & Andrić, M. (2015). Testing the models for detection of earnings management. *Industrija*, 43(3), 55-79. <https://doi.org/10.5937/industrija43-8035>
- Bisogno, M., & Donatella, P. (2022). Earnings management in public-sector organizations: A structured literature review. *Journal of Public Budgeting, Accounting & Financial Management*, 34(6), 1-25. <https://doi.org/10.1108/JPBAFM-03-2021-0035>
- Bonić, Lj. & Đorđević, M. (2018). *Interna revizija u javnim preduzećima u Republici Srbiji [Internal audit in public companies in the Republic of Serbia]*. In: XIII Međunarodni Kongres računovođa i revizora Crne Gore: Računovodstvena i revizorska profesija budućnosti: Povjerenje - Integritet – Transparentnost.
- Capalbo, F., Frino, A., Mollica, V., & Palumbo, R. (2014). Accrual-based earnings management in state owned companies: Implications for transnational accounting regulation. *Accounting, Auditing & Accountability Journal*, 27(6), 1026-1040. <https://doi.org/10.1108/AAAJ-06-2014-1744>
- Dechow, P. M., & Skinner, D. J. (2000). Earnings management: Reconciling the views of accounting academics, practitioners, and regulators. *Accounting horizons*, 14(2), 235-250. <https://doi.org/10.2308/acch.2000.14.2.235>
- Doan, T. N., Ta, T. T., & Pham, D. C. (2021). Audit opinion and earnings management: Empirical evidence from Vietnam. *Investment Management and Financial Innovations*, 18(4), 131-140. [http://dx.doi.org/10.21511/imfi.18\(4\).2021.12](http://dx.doi.org/10.21511/imfi.18(4).2021.12)
- Francis, J. R., & Krishnan, J. (1999). Accounting accruals and auditor reporting conservatism. *Contemporary accounting research*, 16(1), 135-165. <https://doi.org/10.1111/j.1911-3846.1999.tb00577.x>
- Gajevszky, A. (2014). The Impact of Auditor's Opinion on Earnings Management: Evidence from Romania. *Network Intelligence Studies*, II,1(3), 61-73. Retrieved from: https://seaopenresearch.eu/Journals/articles/NIS_3_8.pdf Accessed on: 16 August 2022.
- Garcia-Blandon, J., Bosch, J. M. A., & Martinez-Blasco, M. (2014). Earnings Management and Audit Qualifications: A Non-Matched Sample Approach. *Research in Finance*, 29, 29-62. [https://doi.org/10.1108/S0196-3821\(2013\)0000029005](https://doi.org/10.1108/S0196-3821(2013)0000029005)
- Hamid, F., Hashim, H. A., & Salleh, Z. (2012). Motivation for earnings management among auditors in Malaysia. *Procedia - Social and Behavioral Sciences*, 65, 239-246. <http://dx.doi.org/10.1016/j.sbspro.2012.11.117>
- Healy, P. M., & Wahlen, J. M. (1999). A review of the earnings management literature and its implications for standard setting. *Accounting horizons*, 13(4), 365-383. <https://doi.org/10.2308/acch.1999.13.4.365>
- Imen, F., & Anis, J. (2021). The moderating role of audit quality on the relationship between auditor reporting and earnings management: empirical evidence from Tunisia. *EuroMed Journal of Business*, 16(4), 416-430. <https://doi.org/10.1108/EMJB-03-2020-0024>
- International Auditig and Assurance Standards Board (IAASB) (2015). *International Standard on Auditing 705 (Revised) Modifications to the Opinion in the Independent Auditor's Report*. Retrieved from: <https://www.iaasb.org/publications/international-standard-auditing-isa-705-revised-modifications-opinion-independent-auditors-report-4> Accessed on: 21 August 2022.
- Moazedi, E., & Khansalar, E. (2016). Earnings Management and Audit Opinion. *International Journal of Economics and Finance*, 8(4), 113-122. <https://doi.org/10.5539/ijef.v8n4p113>
- Othman, H. B., & Zeghal, D. (2006). A study of earningsmanagement motives in the Anglo-American and EuroContinental accounting models: The Canadian and French cases. *The International Journal of Accounting*, 41(4), 406-435. <https://doi.org/10.1016/j.intacc.2006.09.004>
- Othman, A. B., Ruslan, N. A., Shamsuddin, I. F., Rosli, N. A., & Janjori, S. R. (2017). A Study on Audit Opinion and Earning Management Between PN17. Companies and Healthy Companies. *International Journal of Business, Economics and Law*, 12(1), 6-12. Retrieved from: <https://www.ijbel.com/wp-content/uploads/2017/05/ACC-93.pdf> Accessed on: 21 August 2022.

- Nguyen, H. A., & Nguyen, H. L. (2016). Using the M-score model in detecting earnings management: Evidence from non-financial Vietnamese listed companies. *VNU Journal of Economics and Business*, 32(2), 14-23.
- Ronen, J., & Yaari, V. (2008). *Earnings management – emerging insights in theory, practice, and research*, Springer, New York
- Ruggiero, P., Sorrentino, D., & Mussari, R. (2022). Earnings management in state-owned enterprises: bringing publicness back in. *Journal of Management and Governance*, 26, 1277-1313. <https://doi.org/10.1007/s10997-021-09589-3>
- Sharf, N., & Nassar, M. A. (2021). The Effect of Audit Quality and Auditor's Opinion on Earnings Management: Evidence from Jordan. *Jordan Journal of Business Administration*, 17(2), 236-253. <https://journals.ju.edu.jo/JJBA/article/view/101354>
- State Audit Institution (2018, 2019, 2020, 2021). *Annual Activity Reports for 2018, 2019, 2020 and 2021*. <https://www.dri.rs/dokumenti/godisnji-izvestaji-o-radu.93.html>
- Tsipouridou, M., & Spathis, C. (2014, March). Audit opinion and earnings management: Evidence from Greece. *Accounting Forum*, 38(1), 38-54. <https://doi.org/10.1016/j.accfor.2013.09.002>
- Veronica, A., & Julisar, J. (2021, May). Factors that Influence the Auditors in Issuing Qualified Opinion. In *Proceedings of the Ninth International Conference on Entrepreneurship and Business Management (ICEBM 2020)* (pp. 144-151). Atlantis Press. <https://dx.doi.org/10.2991/aebmr.k.210507.022>

MODIFIKOVANO MIŠLJENJE REVIZIJE I UPRAVLJANJE DOBITKOM U JAVNIM PREDUZEĆIMA – STANJE U SRBIJI

Cilj autora ovog rada jeste da istraže vezu između upravljanja dobitkom i modifikovanog mišljenja revizora u javnim preduzećima u Republici Srbiji. Uzorak istraživanja čine 64 javna preduzeća čiji su finansijski izveštaji bili predmet revizije od strane Državne revizorske institucije u periodu 2018-2021. godine. Za potrebe identifikovanja upravljanja dobitkom u ovim javnim preduzećima korišćeni su finansijski izveštaji u periodu 2018-2021. Rezultati istraživanja ukazuju da ne postoji pozitivna veza između upravljanja dobitkom i modifikovanog mišljenja revizora, odnosno da razlika u distribuciji modifikovanog mišljenja u javnim preduzećima u kojima je identifikovano i onima u kojima nije identifikovano upravljanje dobitkom nije statistički značajna. Ovakvi rezultati inicijalno upućuju na zaključak da revizori ne uzimaju u obzir upravljanje dobitkom prilikom formiranja mišljenja, te ne šalju upozoravajuće signale korisnicima finansijskih izveštaja. Međutim, ukoliko se sagleda distribucija modifikovanog mišljenja o finansijskim izveštajima javnih preduzeća u kojima je identifikovano upravljanje dobitkom, a posebno motiv upravljanja dobitkom, može se reći da su revizori Državne revizorske institucije adekvatno posvećeni ovom pitanju.

Ključne reči: *diskrecioni obračun, manipulacije, mišljenje sa rezervom, negativno mišljenje, uzdržavanje od mišljenja*