FACTA UNIVERSITATIS
Series: **Economics and Organization** Vol. 16, N^o 1, 2019, pp. 89 - 101
https://doi.org/10.22190/FUEO1901089J

Review Paper

THE ROLE OF AUDIT AND CREDIT RATING AGENCIES IN THE ASSESSMENT OF COMPANY CREDITWORTHINESS WITH SPECIAL FOCUS ON BANKS

UDC 657.6:347.734

Mirjana Jemović, Milica Đorđević, Jelena Radojičić

Unversity of Niš, Faculty of Economics, Niš, Serbia

Abstract. *Audit and credit rating agencies have a significant responsibility in assessing company creditworthiness and giving opinions on the client's ability to continue business in the future, most often the next fiscal year. Responsibility is even greater when it comes to banks and their creditworthiness. The financial crisis of 2007 and the bankruptcy of a number of banks and other financial institutions imposed a need to seek accountability for the "delayed" reaction of regulatory bodies and significant fiscal consequences of the crisis. The aim of the paper is to evaluate the efficiency of credit rating agencies and external audit in assessing the creditworthiness of companies and banks, not for the purpose of finding their individual responsibilities, but to look at possible coordinated and joint actions to prevent future crisis events.*

Key words: *credit rating agencies, external audit, creditworthiness, financial crisis*

JEL Classification: G21, G24, G28, M42, M48

INTRODUCTION

Investors make investment decisions based on information they have about company creditworthiness. For these reasons, companies listed on the stock market are obliged to report on their operations by publishing their financial statements. In order to reduce information asymmetry between issuers of securities and investors, numerous bodies and agencies assess company creditworthiness. A special emphasis in this paper is given to the role and importance of external audit and credit rating agencies in assessing possible company bankruptcy. The auditor's task is, among other things, to assess whether there is a realistic prospect that the company will continue its business in the following period, at least in the

Received September 10, 2018 / Revised January 16, 2019 / Accepted January 28, 2019
Corresponding author: Mirjana Jemović
Faculty of Economics Niš, Trg kralja Aleksandra 11, 18000 Niš, Serbia
E-mail: mirjana.jemovic@eknfak.ni.ac.rs

next fiscal year, and present the so-called *going concern opinion (GCO).* At the same time, credit rating agencies give opinions on the company ability to settle its liabilities to creditors in a timely and complete manner. The financial crisis of 2008 raised the issue of the responsibility of auditors and credit rating agencies for initiating and spreading the crisis by giving optimistic estimates of company creditworthiness immediately before their bankruptcy. In this regard, the paper aims to assess the role of audit and credit rating agencies in assessing company creditworthiness, with special focus on banks. The structure of the paper, in addition to introduction and conclusion, consists of four parts. The first part presents alternative approaches to the assessment of company and bank creditworthiness. The second and third sections consider the role of audit and credit rating agencies in anticipating bankruptcy of companies and banks, while the final part of the paper analyzes the impact of the global financial crisis on the redefining role of credit rating agencies and audit in assessing the company creditworthiness, with the aim of their cooperation, rather than isolated activities in the future.

1. Approaches to the Assessment of Company and Bank Creditworthiness

Assessing creditworthiness of companies in general, and banks in particular, is a very sensitive task. Basically, it implies assessing the ability of a particular entity to continuously perform the activities for which it was founded. As such, it involves an analysis of various aspects of company operations, taking into account its liquidity, efficiency, and solvency. Among them, the most important aspect of the analysis when deciding on the continuity of business activities is the assessment of company solvency.

Solvency is especially important with banks, given that these are institutions that finance most of their activities (80%-90%) using other people’s resources. In addition to being a condition for bank establishment, solvency also represents the criterion for intervention in the banking sector. As this involves bank restructuring measures or its exit from the market through bankruptcy/liquidation procedure, the following question arises: What are the threshold conditions, as the basis for intervention of the relevant regulatory body?

Solvency can be determined in different ways. Thus, we distinguish “liquidity test”, based on the cash flow test, according to which the company is insolvent in a situation when it is unable to settle its due liabilities (equity insolvency), and balance sheet insolvency, according to which the company is insolvent when its liabilities exceed assets, i.e. in case of negative net value. The first test rather corresponds to what is commonly called “illiquidity” and it is not relevant to banks since they can quickly overcome the short-term deficit of funds, while the second test entails a delayed reaction by the regulatory authority and implies the initiation of a bankruptcy or liquidation procedure. As the supervisory authorities are in charge of controlling and monitoring bank operations, it is their duty, in a situation when they see the tendency of bank capital reduction, on the one hand, and the deterioration of the quality of assets, on the other hand, to propose appropriate bank restructuring measures. Therefore, the bank is insolvent when the supervisor says it is insolvent (Hupkes, 2005). Here we are talking about the so-called regulatory insolvency, which allows the intervention of the regulatory authority much before the net value of the bank’s assets reaches a negative value (Čihak & Nier, 2012).

Previous arguments indicate that the supervisor is responsible for identifying the optimal moment for bank intervention. The question is what is the point, i.e. threshold to be crossed, which requires the restructuring of the institution? This threshold should be set so that the position of the institution is significantly compromised, but that it is still solvent, i.e. that it has a positive net value. This is extremely important given that postponing bank restructuring may result in narrowing the choice of effective options for restructuring the institution, which ultimately increases the costs of this process.

Depending on how the intervention "threshold" is defined, we distinguish a hard and soft approach, the first being based on a predefined rule for intervention, and the second implying a greater degree of discretion. The first approach generally involves quantitative determination of the intervention threshold. Thus, the US Federal Deposit Insurance Corporation (FDIC) defines intervention threshold by determining the lower limit of capital adequacy ratio of 2%. The second approach, however, implies a qualitative determination of the intervention threshold (e.g. violation of laws, failure to comply with prudential or regulatory thresholds, supervisory orders, etc.), and is based on the regulatory authority's assessment of the bank's ability to further perform the activities for which it was licensed (Čihak & Nier, 2012). Such an approach is applied in the UK.

When choosing an appropriate approach, it should be kept in mind that a rule-based approach reduces the possibility of regulatory hesitation and increases transparency, while discretionary approach provides an opportunity to see banking failures from a broader perspective and provides a more complete assessment of the institution's situation. Discretion is particularly suitable for quick action in a situation where the financial institution's state of affairs is rapidly deteriorating, for example, for losing access to key market segments of the source of funds, which in quantitative thresholds may not be adequately valued. For these reasons, these approaches are often combined.

Bank closure, although sometimes the only solution, leaves many negative consequences. Specifically, the reduced supply of banking services within a national economy ultimately has a negative impact on the overall economic development of the country. For these reasons, the competent regulatory authority should at any time assess whether a better solution is the restructuring of a financial institution in order to keep it going (going concern), or its closure through liquidation/bankruptcy (gone concern). In giving such assessments, external audit and credit rating agencies play an important role, which will be discussed below.

2. The Role of Audit in Predicting Company Bankruptcy

Financial statements that show the financial and income position of the company are at the same time one of the ways of expressing the management responsibility (Farhana, et al., 2017, p.33). With this in mind, the use of creative accounting techniques to project a good company image, all with the aim of attracting new investment, is not a novelty in accounting practice. Therefore, audit of financial statements, aimed at assessing whether financial statements are, in all essential matters, drawn up in accordance with the identified financial reporting framework, is of particular importance, as it affects the decision on whether to rely on them in the analysis. By reducing the information asymmetry between agents that supply and demand for capital, audit improves investors' awareness about the risk of investing in a specific company (Kondić & Poljašljević, 2015), and it is not uncommon to hear that auditors stand for significant truth creators whose objective communication of the company situation enables the making of rational investment decisions (Sikka, 2009).

Certainly, audit contribution to the successful capital market is conditioned by the adequacy of the audit process itself (George-Silviu, Melinda-Timea, 2015). In addition to a detailed and independent review of financial statements, one of the most relevant judgments of auditors that can influence the capital market (Blay, et al., 2011) is auditor's assessment and expression of an opinion on the client's ability to continue their business in the foreseeable future (in practice defined as the next fiscal year). First, auditors need to evaluate whether managers prepared financial statements based on the principle which all accounting standards rely on – the principle of *business continuity*, and then to obtain audit evidence in order to conclude that there are material uncertainties about the entity's capability to continue business on a principle of continuity. The auditor's opinion in which the client's business continuity is endangered can be considered a very serious warning that the company will experience bankruptcy.

Within the scope of the audit process, assessing the client's business continuity assumption is a very complex, difficult, and two-phase process. First, the auditor needs to identify possible problems related to the client's business continuity (which reflects their competence), and then report on this problem (which is a reflection of their independence). The auditor's ability to identify problems is conditioned by the possession of an adequate experience, a significant focus on the assessment of business continuity, increased public pressure, focus on future events, ownership of resources, etc. Regarding the issue of disclosure of identified problems, the auditor will report if they face a high level of independence, if they want to avoid possible litigation and have an aversion to reputational risk. Bearing in mind these factors, but also the fact that they cannot anticipate future events with certainty, the auditor can make two types of errors:

- Type I error – when the auditor doubts the company business continuity, and the company continues to operate, and
- Type II error – when the auditor issues an unmodified opinion without drawing attention to the matter, and the client goes bankrupt or faces liquidation next year.

The consequences of auditors' errors are significant. In the case of a Type I error, the auditor is at risk of losing further cooperation with the client, while the company may be harmed in terms of declining reputation on the capital market, losing investors, etc. On the other hand, the Type II error consequences are reflected in the loss of auditor reputation and the client's decision to file a lawsuit. Nevertheless, Lai (2009) argues that the consequences of the Type II error are much more serious and far-reaching. This is supported by the fact that auditors issued an unmodified opinion on the financial statements of companies that were at the center of financial scandals[1]. This aroused considerable big suspicion about auditing profession because many thought that the collapse of those companies could have been avoided if auditors had not been wrong and had given warnings about the bad state of the companies that later went bankrupt. In addition to these scandals, auditors were also criticized in 2008 for failing to warn of the upcoming bank collapse that marked the onset of the financial crisis. In this sense, financial scandals and then the crisis suggested the existence of "possible problems in achieving greater independence of auditors and the need to improve audit procedures, especially with regard to auditing the business continuity assumption" (Socol1, 2010, p. 291). Therefore, the International Auditing and Assurance

[1] Examples of large audit failures relate to Enron and World Com. As a result of accounting frauds, these companies were bankrupt, while Arthur Andersen audit firm previously issued a positive opinion on the financial statements.

Standards Board (IAASB) carried out several revisions of the 570 Standard – The Business Continuity Principle (the last revision was carried out in 2015), and issued reports that paid more attention to and gave a new description of the responsibilities of auditors and management in relation to this assumption. In this regard, the company management is obliged to evaluate the company ability to continue its operations based on the business continuity principle (IAS 1), while the auditor should evaluate the management's assessment of the company ability to continue its business. In the course of this evaluation, the auditor should include the same period that the management has observed and consider whether the management's assessment covers all the relevant information that the auditor has come to during the audit. In addition, the auditor's objectives are to (ISA 570, par. 9):

- Obtain sufficient and adequate audit evidence and make conclusion on the appropriateness of applying the accounting principle of business continuity,
- Make conclusion as to the material uncertainty in relation to events or conditions that may cast significant doubt on the ability of the entity to continue its business, and
- Make a report in accordance with the conclusion.

In assessing the company's ability to continue its business, auditors use different techniques. The most common are the so-called accounting-based valuation models that use statistical methods to predict company bankruptcy, mostly relying on data contained in the client's financial statements, i.e. the analysis of traditional financial statements. Thus, during the 1970sand 1980s, Altman's model, the Ohlson model, and the Zmijewski model were developed. Later, information technology enabled the development of advanced techniques such as data mining, intelligent modelling techniques, and neural networks.

Factors that affect the auditor's opinion to draw attention to the threat of business continuity are numerous. Carson et al. (2013) summarize the results of numerous studies, and, apart from auditor characteristics (independence from the client, professional relationship with the client, high judgment ability, etc.), all the factors on the client's side are divided into the following:

- *Business difficulties that are evident from financial statements*: low profitability, high leverage, low liquidity, high level of indebtedness, and drawing attention to business continuity in previous audits,
- *Business difficulties identified on the basis of (1) market variables* (lower industry-adjusted returns and higher return volatility); and (2) *management plans* to issue equity and plans to borrow,
- *Large negative accruals reflecting the weak financial conditions in the company,*
- *High quality of corporate governance*: a higher level of independence of the audit committee and higher expertise in corporate governance also imply greater auditor protection from the cancellation of further engagement after doubts as to business continuity,
- *The carrying amounts of assets in financial statements are high relative to their expected realizable values in the event of bankruptcy*.

Depending on the evaluation of the management's assessment of the company's ability to continue business, as well as the established facts and circumstances in the company, the auditor issues an appropriate opinion (Table 1).

Table 1 The connection between going concern assumption and the auditor's opinion

The management's uses of going concern assumption	Material uncertainty (whether the events or conditions constitute a material uncertainty)	The adequacy of related disclosures in the financial statements	Auditors' opinion
Appropriate	Does not exist	Adequate	Unmodified opinion
Appropriate	Exists	Adequate	Unmodified opinion (but have to include an Emphasis of Matter paragraph in the auditor's report)
Appropriate	Exists	Disclosures are not made	Qualified opinion or Adverse opinion
Inappropriate	Exists	Unimportant	Adverse opinion
Inappropriate	Material uncertainties are significant to the financial statements as a whole	Unimportant	Disclaimer of opinion

Source: Adapted after ISA 570

Investors and other users believe in the credibility of the audit opinion. However, the fact is that giving opinions about business continuity is very challenging for auditors because it involves the prior implementation of very complex activities while preserving independence. In that sense, the research subject by numerous authors is the prediction ability of audit opinions regarding the client's business continuity. Kondić and Poljašević (2015) summarize the results of these studies and conclude that the prediction role of the audit opinion is relatively limited, but still with a significant positive effect on the financial stability of the company and its position on the capital market. More specifically, the inclusion of an Emphasis of Matter paragraph on business continuity provides valuable information to investors on the risks that they may encounter in investing in a particular company. In order to get the audit opinion that is reliable and with greater predictive power, the place and role of credit rating agencies are increasingly analyzed in this process. More specifically, auditors and credit rating agencies focus on the same task, assessing the company's creditworthiness, so it is very important to note possible ways of their cooperation.

3. The Role of Credit Rating Agencies in the Assessment of Company and Bank Creditworthiness

The main role of credit rating agencies is to give an opinion on the ability of a specific entity (company, state, local self-government) to timely and fully settle its obligations towards creditors. In a word, the rating agency's task is to give an opinion on the legal entity's overall credit risk (issuer credit rating), assessing the ability and willingness of a particular public or private entity to settle its obligations, or regarding a financial instrument (issue credit rating), assessing the credit risk of a particular security. In the second case, the rating agency first assigns a rating to a company that issues securities, and then rates a particular security. Here, the sovereign credit rating is especially important, bearing in mind that government securities are a benchmark in determining the return on securities of other entities. The assigned credit rating can be changed over time, in case certain factors from internal and external environment in which the borrower operates are not looked at during the initial credit rating analysis, and may affect its ability to settle its obligations.

The basis for the existence of these institutions lies in the information asymmetry that exists between issuers of securities, on the one hand, and investors, on the other. This problem was initially not so apparent as there were state and local government bonds on the market. However, the offer of an increasing number and types of securities, primarily private ones, imposed the need for investors to base their decisions on agencies' ratings. This information has become an indispensable element in making investment decisions, primarily of smaller investors who were not able to come to information about the company creditworthiness in some other way.

Credit rating agencies are relatively young institutions that first appeared on the US market at the beginning of the 20th century, when there was an increased need to finance the railway construction. In the short term, by the end of the 20th century, rating agencies experienced explosive growth, given the growing number of ratings assigned. Among them, three credit rating agencies took the highest market share (as much as 95%), S & P, Moody's, and Fitch, respectively. In addition, the US Securities and Exchange Commission (SEC) began the practice of Nationally Recognized Statistical Rating Organizations (NRSROs), which further concentrated the rating agency market.

The widespread use of agency ratings also came out of simplicity of interpreting the ratings, where one symbol sublimates the total entity or security credit risk (Kožul, 2012). The first four letters of the alphabet (A-D) are used to denote the credit rating of a particular security, where the classification is done according to the degree of risk in two grades: investment and speculative (Table 2). Within the defined grades, ratings are hierarchically set, from the highest to the lowest.

Table 2 S & P, Fitch and Moody's ratings

Rating	S&P/Fitch	Moody's
Investment grade	AAA	Aaa
	AA	Aa
	A	A
	BBB	Baa
Speculative grade	BB	Ba
	B	B
	CCC	Caa
	CC	Ca
	C	C
	D	

Source: Standard&Poor's, 2018 (www.spratings.com); Moody's, 2018 (https://www.moodys.com/Pages/amr002002.aspx); Fitch, 2018 (https://www.fitchratings.com/site/definitions)

Regulatory authorities at the international and national level strengthened the position of credit rating agencies, by adopting regulations that limit the investment activity of certain financial institutions exclusively to securities with high credit ratings. For example, contractual savings institutions (insurance companies and pension funds) have a strictly defined investment policy characterized by elements of prudence and security of investment, which means investing in securities with small but secure return, i.e. in securities with high credit rating (Jovanović, 2013, p. 255). Similar rules are embedded in banking laws, in the sense that banks can invest exclusively in securities with investment rating. Ratings have significant implications on the stock market, in the sense that stock prices rise in conditions of credit rating growth, and vice versa in the event of a downturn. The significance of credit rating agencies and their ratings was especially evident with the securitization of mortgage loans and the emergence of derivative securities.

In recent years, ratings have also been used as an instrument for the supervision and regulation of entities and institutions operating on the financial market (Pavković & Vedriš, 2011). The rating agencies themselves are, on the other hand, poorly regulated. In order to facilitate issuers' access to the capital market and allow for more favorable indebtedness, rating agencies made "settlements" with issuers, which resulted in higher rating of their securities. As compensation, credit rating agency received a fee from the issuer higher than that paid by investors (Issuer Pays vs. Subscriber Pays). This type of compensation was especially apparent with the appearance of structural products, i.e. securities issued in the process of securitization of mortgage loans. The situation in which the rated firms actually pay for rating raised suspicion as to the independence of rating agencies and the objectivity of the ratings given. In addition, market globalization brought higher ratings to global companies compared to the sovereign, which put pressure on the rating agency to give sovereigns a more favorable rating (Kožul, 2012). Providing advisory services by rating agencies is another reason for questioning the independence of rating agencies.

A system in which investors as primary rating users are in a more unfavorable situation than issuers, and where issuers actually "order and buy" ratings, has created the basis for numerous abuses by credit rating agencies. The first case of such abuse was recorded with ENRON, which was assigned investment rating immediately before its bankruptcy. A similar situation took place during the financial crisis of 2008, in the case of Lehman Brothers. Specifically, the rating agency assigned this institution an investment rating, and as an argument for such a rating stated the open willingness of the FED to provide liquidity support to this institution. Although the investment bank does not have the exclusive right to use a discount counter or any other financial safety net, such an intervention is often considered justifiable in the case of too big or too systemic to fail institution. In addition, errors were made in the rating of structural products (derivative mortgage securities) of this investment bank. The existence of insurance and external and internal guarantees, in particular the presence of numerous participants in the process of securitization of mortgage loans, concealed the risk that investors may be exposed to by purchasing such securities. Bankruptcy of this investment bank only a few months after the favourable rating has given opened polemics about the accuracy and reliability of ratings. Investors that invested considerable amounts into securitized securities of this investment bank found themselves in the position of impossibility to sell these securities. Bearing in mind that audit companies made a mistake in giving GCO to ENRON, a question arose as to who was responsible for not seeing bankruptcy on time in the latest financial crisis: credit rating agencies or audit firms.

4. GLOBAL FINANCIAL CRISIS AND REVIEWING THE ROLE OF CREDIT RATING AGENCIES AND AUDIT IN THE ASSESSMENT OF COMPANY CREDITWORTHINESS

The relationship between credit rating agencies and audit was particularly pronounced with the recent financial crisis, which led to the constant search for a "culprit" for the untimely signalling of the bankruptcy of a number of companies in the financial sector. Bearing in mind that credit rating agencies and auditors, based on the information they possess, try to assess the company's ability to continue operations, their approaches are quite different.

Credit rating agencies focus primarily on credit risk, while auditors focus on assessing the reliability and accuracy of financial statements as a whole. In addition, all companies listed on the stock market are by law subject to audit, while such an obligation does not exist in the case of credit rating agencies. Nevertheless, investors appreciate agency ratings much more than a set of accounting variables (Cha, et al., 2016). Bearing in mind that credit rating agencies do not aim to evaluate the viability of a particular investment, but the ability of a particular entity to settle the debt, such an assessment could be a significant input to the auditor in giving the GCO. On the other hand, prior to assessing the company creditworthiness, rating agencies most often state as a condition that the company has been subject to audit in the previous three years. This is because financial statements are more and more difficult to understand and often contain incorrect and unreliable data (Mrvić, et al., 2016).

Despite numerous criticism of credit rating agencies, they were not subject to special regulations until the recent financial crisis. The pressure of investment public on the SEC in 2003 and 2006 resulted in only a slight increase in the number of NRSROs[2]. The more conservative auditor approach in relation to credit rating agencies, as well as the huge dissatisfaction of investment public with the work of these agencies, led in 2010 to the new law that puts special emphasis on the protection of users of financial services, which, in the domain of rating agencies, means protection of investors. The emphasis is not only on the establishment of an adequate supervision and regulation system of rating agencies, but also mechanisms of their self-regulation, greater transparency of the rating process, and the methodologies they use in assessing the creditworthiness of securities and issuers (Pavković & Vedriš, 2011). A special body for the regulation and supervision of credit rating agencies (European Securities and Markets Authority) has even been established in Europe.

In spite of numerous efforts to increase transparency and better regulate the work of rating agencies, the ratings they give should be taken only as a reference point, rather than as a direction for a future investment decision. In the context of improving the efficiency of credit rating agencies and auditors in assessing the company creditworthiness, there are more and more proposals towards the development of cooperation between rating agencies and auditors. Integration of ratings into the audit review system would give an objective assessment of company creditworthiness, especially those that are approaching bankruptcy.

Credit rating agencies and auditors provide important information to investors and potentially function as substitutes (Lammers, 2013). However, in addition to high informative potential, they are also characterized by imprecision in predicting future. For example, inadequate credit ratings played a significant role in the development of the global financial crisis (Mulligan, 2009; Ozerturk, 2014). While the assumption about the safety of

[2] Since 2008, there are 10 NRSROs.

banks was based on public sector guarantees, assumption about the safety of unregulated financial institutions relied on guarantees provided by the private sector in the form of a credit rating (Adrian & Ashcraft, 2012). The obligations of these institutions were secured with high liquid assets with an AAA rating. The task of rating agencies was to guarantee objective credit rating of banks and financial instruments, but they were in conflict of interest because issuers paid for credit ratings (De Grauwe, 2009). Rating agencies increased profits on the basis of the growth of the securities market in the process of securitization of sub-prime mortgage loans. At the same time, they encouraged the growth of this market by giving high ratings to these instruments, for which investors perceived them as low-risk investment (Adrian & Ashcraft, 2012). The agencies based their ratings on the assumption that securities generated in the process of securitization were low-risk due to diversification achieved by grouping loans from different regions, protection coming from subordinate tranches, and credit enhancements by additional guarantees of their recovery (Wilmarth, 2009). Resecuritization led to the emergence of an additional market for securities from securitization, thus increasing the complexity of financial instruments. This process was followed by credit rating inflation (Blundell-Wignall, et al., 2012). For example, investors rated mezzanine tranches of financial instruments created on the basis of subprime mortgages as too risky in relation to the yield they brought, and resecuritization transformed them into instruments that received the AAA rating (Wilmarth, 2009). The advent of the financial crisis created a problem of non-performance of securities with high credit rating created in the process of securitization of bad mortgage loans.

Another criticism related to credit rating agencies refers to their sensitivity with credit rating revision. The timeliness of credit rating change and credit rating stability are two opposing goals, the balance of which is a challenge for rating agencies. Changes in the credit rating may indicate a possible company bankruptcy in the future, but agencies are sometimes characterized by a delay in understanding the right situation in terms of changing the creditworthiness of companies. The reasons behind the lag in adjusting the rating to change in the company's financial position may be different: the rating agencies' inability to get timely information, inadequate methodology, periodicity of rating change, etc. Rating agencies can also conduct a policy of issuing stable ratings to focus on the long-term perspective of companies' creditworthiness rather than on temporary and transient changes in credit risk (Altman & Rijken, 2004). One of the reasons for the delay in rating revision is the rating agencies' efforts to meet clients' expectations regarding rating stability, as rating changes require frequent and costly adjustments in their portfolios (Loffler, 2005). This would require investors to trade in securities often, which would expose them to higher transaction costs. On the other hand, in times of crisis, the timely credit rating adjustment to changes in companies' credit risk is gaining importance for investors.

The problem of delays in the credit rating revision was confirmed during the global financial crisis. The rating agencies assigned high credit ratings to AIG and Lehman Brothers just before their collapse.

Despite the criticism of rating agencies, the problems that put them at the heart of the global financial crisis, such as investor over-reliance on credit ratings, insufficient supervision, lack of accountability and inadequate methodology used by rating agencies, continue to be present in the post-crisis period (Partnoy, 2017).

The global financial crisis has led to the review of audit practice so that criticism did not go past auditors. Some criticism relates to the impossibility of signaling financial risks and the lack of GCO disclosure in the case of banks (Harris, 2011). Also, the financial crisis has shown that some banks were in trouble and had to be saved or went bankrupt in the short term after receiving an unqualified audit report. This was the case, for example, with Lehman Brothers (date of audit report 28th January 2008), Bear Stearns (date of audit report 28th January 2008), Barclays (date of audit report 7th March 2008), Royal Bank of Scotland (27th February 2008), UBS (date of audit report 6th March 2008), and others (Sikka, 2009). This raises the question of the role, objectivity, and independence of the auditor's opinion for the financial institutions sector.

From the point of view of information about the anticipation of company bankruptcy, one can also observe the relationship between the auditor's opinion and credit rating. Comparing credit ratings and auditor's opinions available before company bankruptcy gives the opportunity to investigate who has greater success in predicting and signaling bankruptcy. There is a small number of studies in literature dealing with this issue.

Empirical research carried out by Cha, Hwang and Yeo (2016) in 100 Korean companies in the period from 2007 to 2014 shows that the audit system is more conservative, and, therefore, more successful in signaling bankruptcy, while rating agencies are characterized by excessive optimism due to less responsibility to issue corporate ratings. Since1990s , auditors have been facing tightening regulations and greater responsibility when doing business. The possibility of initiating a lawsuit against the auditor for damages in providing audit services to third parties such as investors brought high lawsuit costs to largest audit firms (about 15% of revenue) in 2007 (Center for Audit Quality, 2008). Efforts to improve the quality of audit were particularly intensified after the accounting scandal with Enron and subprime mortgage crisis. Feldmann and Read (2013) find that the GCO disclosure is related to the company's credit rating, and that, after the GCO disclosure, credit rating falls. This indicates a higher informative value of the auditor's opinion than the rating agency.

Notwithstanding the criticisms made to auditors and rating agencies, credit ratings as well as auditor's opinions play an important role in preserving the efficiency of capital markets (Dodd-Frank Act, 2010, Section 931, par. 1). Credit ratings, as the assessment of companies' creditworthiness, affect their costs and their financial structure (Baber, 2014). Auditors do not give opinion on credit ratings, but report on the company ability to continue to operate, which may have a negative impact on stock returns (Kausar, et al., 2009). That is why, during the post-crisis period, proposals appeared to decrease the difference between credit rating agencies and auditors in such a way that rating agencies include the auditor's opinion in the credit rating revision, while the auditor's opinion would include a credit rating. Hu (2011) even explores the potential benefits of the convergence of rating agencies and auditors and the merging of their functions into one activity or a strategic alliance (GC rating or audit rating).

CONCLUSION

The assessment of company creditworthiness in general, and banks in particular, is a very complex task and requires an analysis of different business aspects. What are the real prospects for the company to continue its business, most often in the next fiscal year, is the subject of evaluation by numerous agencies, institutions, and bodies. The paper analyzes in particular the role of external audit and rating agencies in making such an assessment.

The task of an auditor is to give an opinion on the client's business continuity based on the evaluation of the management's assessment of the company's ability to continue its operations, as well as the established facts and circumstances regarding the company. Credit rating agency, on the other hand, gives an opinion on the credit risk of a legal entity or a financial instrument. The auditors and rating agencies' focus on company creditworthiness makes room for their cooperation, which would give the audit opinion more reliability and greater predictive power, and ratings would be more realistic. Integration of ratings into the audit system would bring an objective assessment of companies' creditworthiness, especially those that are approaching bankruptcy.

The relationship between credit rating agencies and audit was particularly pronounced during the recent financial crisis, during which auditors stepped forward with a more conservative approach than was the case with rating agencies. For these reasons, in the following period, special attention should be paid to the establishment of an adequate system of supervision and regulation of credit rating agencies, as well as the development of their self-regulation mechanisms, greater transparency of the rating process, and the methodology they use when rating securities and issuers. Additionally, in the post-crisis period, there are more and more proposals for convergence of rating agencies and auditors and the merging of their functions into one activity or a strategic alliance.

REFERENCES

Adrian, T. & Ashcraft, A.B. (2012). Shadow Banking Regulation. *Staff Report No. 559*. Federal Reserve Bank of New York.

Altman, E. & Rijken, H. (2004). How Rating Agencies Achieve Rating Stability. *Journal of Banking and Finance*, 28, 2679-2714.

Baber, G. (2014). The role and responsibility of credit rating agencies in promoting soundness and integrity. *Journal of Money Laundering Control, 17* (1), 34-49.

Blay, A.D., Geiger, M.A. & North, D.S. (2011). The Auditor's Going-Concern Opinion as a Communication of Risk. *Auditing: A Journal of Practice & Theory*: May 2011, 30 (2), 77-102.

Blundell-Wignall, A., Atkinson, P. E. & Roulet, C. (2012). The Business Models of Large Interconnected Banks and the Lessons of the Financial Crisis. *National Institute Economic Review*, 221, 31-43.

Carson, E., Fargher, N.E., Geiger, M.A., Lennox, C.S., Raghunandan, K. & Willekens, M. (2013). Audit Reporting for Going-Concern Uncertainty: A Research Synthesis. *Auditing: A Journal of Practice & Theory*, 32 (1), 353-384.

Center for Audit Quality (2008). Report of the major public company audit firms to the department of the Treasury Advisory Committee on the auditing profession, Washington, DC.

Cha, M., Hwang, K., & Yeo, Y. (2016). Relationship between Audit Opinion and Credit Rating: Evidence from Korea. *The Journal of Applied Business Research*, 32 (2), 621-634.

Čihak, M., & Nier, E. (2012). The need for special resolution regimes for financial institutions - The case of the European Union. *Harvard Business Law Review*, 2, 396-434.

De Grauwe, P. (2009). Lessons from the banking crisis, a return to narrow banking. *CESifo DICE Report,* 7 (2), 19-23.

Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law Number 111-203 (2010). Government Printing Office, Washington, DC*3, H.R. 4173*.

Farhana, I., Rahmawaty & Basri, H. (2017). The Determinants of Going Concern Audit Opinion (An Empirical Study on Non-Bank Financial Institutions Listed in Indonesian Stock Exchange 2008-2014). *Journal of Accounting, Finance and Auditing Studies*, 3 (4), 32-51.

Feldmann, D., & Read, W. J. (2013). Going-concern Audit Opinions for Bankrupt Companies – Impact of Credit Rating. *Managerial Auditing Journal,* 28 (4), 345-363.

George-Silviu, C. & Melinda-Timea, F. (2015). New audit reporting challenges: auditing the going concern basis of accounting. *Procedia Economics and Finance*, 32, 216-224.

Gutierrez, E., F., Krupa, J., Minutti-Meza, M. & Vulcheva, M. (2016). How Useful Are Auditors' Going Concern Opinions as Predictors of Default? SSRN Electronic Journal, https://www1.warrington.ufl.edu/accounting/docs/2016_Paper7.pdf

Harris, S.B. (2011). Concept release on possible revisions to PCAOB standards related to reports on audited financial statements, June 21, available at: http://pcaobus.org/News/Speech/06212011_ HarrisStaement. aspx.

Hu, S. (2011). Convergence of audit and credit rating practices: Going concern ratings. *International Journal of Disclosure & Governance*, *8* (4), 323-338.

Hupkes, E. (2005). Insolvency: why a special regime for banks?. *Current developments in monetary and financial law*, 3, 471-514.

International Standard on Auditing (ISA) 570 (Revised), Going Concern

Jovanović, M. (2013). Slabosti i nedostaci rejting agencija na savremenim finansijskim tržištima [Weaknesses and shortcomings of rating agencies in modern financial markets]. *Ekonomika*, 59 (4), 53-262.

Kausar, A., R. Taffler & C. Tan (2009). The going-concern market anomaly. *Journal of Accounting Research*, 47 (1), 213–239.

Kondić, N. & Poljašević, J. (2015). Auditing predictability of companies bankruptcy, Conference: *Corporate governance in BiH* At: Dubrovnik, Croatia, 69-85.

Kožul, N. (2012). Metodologija kreditnog rejtinga za suverene i korporacije [Credit Rating Methodology for Sovereigns and Corporations]. *Bankarstvo*, 1, 37-54.

Lai, K.W. (2009). Audit opinion and disclosure of audit fees. *Journal of Accounting Auditing and Finance*, 24 (1), 91-114.

Lammers, E.J. (2013). Early warning for business failure, *Kredit & Rating Praxis*, 2013/3, June 24, OK-Score Institute.

Loffler, G. (2005). Avoiding the Rating Bounce: Why Rating Agencies Are Slow to React to New Information. *Journal of Economic Behavior & Organization*, 56, 365-381.

Masyitoh, Oni C. & Adhariani, D. (2010). The Analysis of Determinants of Going Concern Audit Report. *Journal of Modern Accounting and Auditing*, 6 (4), 26-37.

Mrvić, T., Rička, Ž. & Mahmutović, H. (2016). Metodologija kreiranja rejting ocjena kreditnih rejting agencija i njihova ograničenja [Methodology for creating rating ratings for credit rating agencies and their limitations]. *Tranzicija*, 18 (38), 65-83.

Mulligan, C. M. (2009). From AAA to F: How the Credit Rating Agencies Failed America and What Can Be Done to Protect Investors. *Boston College Law Review,* 50 (4), 1275-1305.

Ozerturk, S. (2014). Ratings as regulatory stamps. *Journal of Economic Behavior & Organization, 105*, 17-29.

Partnoy, F. (2017). What's Still Wrong with Credit Ratings? *Washington Law Review*, 92, 1407-1472.

Pavković, A., & Vedriš, D. (2011). Redefiniranje uloge agencija za kreditni rejting u suvremenom financijskom sustavu [Redefining the role of credit rating agencies in the modern financial system]. *Ekonomska misao i praksa*, 20 (1), 225-250.

Sikka, P. (2009). Financial crisis and the silence of the auditors. *Accounting, Organizations and Society*, 34 (6-7), 868-873.

Socol, A., (2010). Significant doubt about the going concern assumption in audit. *Annales Universitatis Apulensis Series Oeconomica*, 12 (1), 291-299.

Wilmarth, A. E. (2009). The Dark Side of Universal Banking: Financial Conglomerates and the Origins of the Subprime Financial Crisis. *Connecticut Law Review*, 41 (4), 963-1050.

ULOGA REVIZIJE I REJTING AGENCIJA U OCENI BONITETA KOMPANIJA UZ POSEBAN OSVRT NA BANKE

Revizija i rejting agencije imaju značajnu odgovornost pri oceni boniteta kompanija i davanju mišljenja po pitanju sposobnosti klijenta da nastavi svoje poslovanje u budućem periodu, najčešće narednoj poslovnoj godini. Odgovornost je utoliko veća kada su u pitanju banke i njihov bonitet. Finansijska kriza iz 2007. godine i bankrotstvo brojnih banaka i drugih finansijskih institucija nametnula je potrebu traženja odgovornosti za "zakasnelu" reakciju regulatornih organa i značajne fiskalne posledice krize. Rad ima za cilj da oceni efikasnost rada rejting agencija i eksterne revizije u oceni boniteta kompanija i banaka, ne u cilju pronalaženja njihove pojedinačne odgovornosti, već sagledavanja moguće koordinirane i zajedničke akcije u sprečavanju budućih kriznih događaja.

Ključne reči: *rejting agencije, eksterna revizija, bonitet, finansijska kriza*