THE GOING CONCERN – THEORY AND PRACTICE IN THE FINANCIAL AUDIT

Tara Ioan Gheorghe
University of Oradea, Economic Sciences Department

Introduction

The whole financial and economic world is really interested in more reliable information so as to be possible to avoid bad events or, perhaps, the crisis.

It is known and equally acknowledged that financial audit might have been more useful in preventing the actual financial crises. It is strongly necessary for further debates on the subject and for the most effective levers to enforce the best practical examples in the field.

Therefore, we consider that a component part of financial audit activity that might be a source for more debates and, as a result, for some better results in performing financial audit, would be both the concept and the practice of "going concern".

The results of our research show that we could reconsider the moment of the going concern assessment. It is not necessary to be performed at the same time with the audit of the annual financial statements. It also might be required by the investors, mainly by the stockholders, at any time they wish. This fact would induce changes in the actual standards statements which refer to auditor's and management's responsibilities regarding "going concern". Not the latest as importance appears the fact that in this situation a larger team, and more competitive, being compounded from a wide range of experts along with the financial auditor, could perform the audit mission of going concern.

The paper is structured as the following: an overview of the main approaches of the subject of "Going concern" in both scientific literature and in the regulators work, the analysis of some data published by The Securities and Exchange Commission (SEC) along with the results and proposals of some other authors in the field, conclusions and my own proposals.

The main scientific background and regular framework

The most recent studies on "going concern" are focused on the following aspects:

The going concern concept and its component part. Thus, *Nirosh Kuruppu, Fawzi Laswad and Peter Oyelere(2003)* accepted that the going concern is a concept that assumes that the reporting entity will continue in operation for the foreseeable future, and that it will be able to realize assets and discharge financial obligations in the normal course of operations.

The methodology of going concern assessment and its impact and connection with the auditor's opinion: *Mahdi Salehi and Co. (2009)* declares that one of the ranking methods in relation with going concern concept is applying financial ratios through a combined form. Liquidation prediction model for assessing going concern can be used as a valuable audit tool due to the high costs associated with misclassifying failing companies argues *Nirosh Kuruppu and Co.*

The behavior of financial auditors facing certain kind of regulations and the practical answer of the management representatives to the modified going concern opinion. *Sylvia Constantinides (2002*) analyzed the influence of a going concern opinion on three categories of actors respectively auditors, bankers and insolvencies practitioners and concluded that there is a different way of behavior. *A.Rosman* (*2011)* found that auditors are adaptive in ill-structured tasks and rigid in structured tasks as predicted by theory. The likelihood of default for firms that received going concern opinion is 2.792 times that of firms that received a clean opinion shows *Alnoor Bhimani , Mohamed Azzim Gulamhussen and Samuel Lopez (2009) from London School of Economics, United Kingdom.*

Marshall A. Geiger, K. Raghunandan, and Dasaratha V. Rama (2005) documented that the increase in going-concern modification rates for bankrupt companies after December 2001 is due to changes in auditor reporting decisions and not solely due to differences in client characteristics between the times periods studied.

The regulations on financial audit started before nineties with the description of going concern principle in 1975 - *IAS 1 Disclosure of Accounting Policies*- continued with US SAS 59 issued in 1988 by American Institute of Certified Public Accountants (AICPA). In 2002 after the famous bankruptcy of Enron, *the Sarbanes Oxley Act* brought tougher regulations that refer to going concern as well. Beginning with 2009, the going concern activity is performed on the basis on the International Standard on Auditing *ISA 570 Going concern a*ccording to which the auditor's responsibility is to obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation of the financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern.

After the financial crisis beginning IFAC issued recommendations both to its members and to the representatives of the G20 members aiming at convincing the decision factors from those countries to take the proper measures in the financial and accounting field, including financial audit, so as some of the crisis' causes to be effectively prevented. Thus, the recommendations for G-20 meeting of April 2009 and of June 2010 refer to the necessity of *Strengthening Transparency and Accountability in the Context of the Audit of Financial Information*. On the same purpose IFAC issued in 2009 the document headed *Audit Considerations in Respect of Going Concern in the Current Economic Environment* that deals with the effect of the credit crisis and economic downturn on an entity's ability to continue as a going concern and whether these effects ought to be described in the financial statements. One of the document key message consists in stressing the fact that going concern assumption is a fundamental principle in the preparation of financial statements and that the assessment of an entity's ability to continue as a going concern is the responsibility of the entity's management.

Method and data

In order to document my opinion of separating the audit mission of a going concern from other auditors' engagements, particularly from the audit mission on the annual financial statements, I used two levers: a study of a sample of data provided by Securities and Exchange Commission (SEC) and an analyses of the most recent scientific papers of other authors dealing with this subject and whose findings entitle me to go forward with the proposal.

On a sample of eighty entities published by SEC on April 18th and April 22th, 2011, at each date forty filing entities, I studied their documents for going to bankruptcy, the moment of filing, the auditor's opinion on the annual financial statements as well as the connection between the financial auditors' opinion and the decision for bankruptcy of these entities management. The SEC information offers a list of the most recently bankruptcies received and processed at SEC. Therefore, those eighty entities sampled at different dates appear relevant to the goal of showing the connection between financial audit opinion and the decision on filing for bankruptcy. After selecting the sample we searched on each entity's own site the latest financial audit report. In this way we found out the moment of the financial audit opinion (before or after filing), the type of decision and finally its connection and influence on the bankruptcy's proceedings.

From the analyzed data encompassed in the (*Table 1)* result the followings:

Table 1. Audit opinions for the sampled entities

Nr	Audit opinion	Date of April 18th 2011	Date of April 22nd 2011	Total	Percentage from total	Number of entities getting the audit opinion	
						Before filing	After filing
1	Going-concern modified	9	11	20	25%	20	_
2	Not modified	28	25	53	66%	23 (43%)	30 (57%)
3	No audit report	3	4	7	9%	_	_
4	Total	40	40	80	100 %	43 (58%)	30 (42%)

Realized by the author

- Only a quarter from all companies got a going concern modified opinion before filing. At the same time these entities represent less than a half (46%) of all entities getting an opinion before filing.
- The majority of all companies got an unmodified opinion and from all of these 57% is represented by those getting it after starting the bankruptcy proceedings. That means that the connection between the decision for bankruptcy and an unmodified opinion hardly exists.
- There are some entities (9%) that maybe did not at all get an audit opinion or their report was not published. Nevertheless, because of their small percentage, they do not affect or change the previous results.
- On the whole, we could assert that a slim majority of the companies got an opinion before filing for bankruptcy and from all of them, a big majority, is represented by those getting an unmodified opinion.
- Studying the content of some auditors' opinions we found that they are strongly criticized by the stockholders' representatives when somebody should account for the bankruptcy situation.

Analyzing the conclusions of the most recently published papers on the subject we found that they consistently support the idea that: financial auditors' behavior concerning the new, stronger regulations or a litigation environment is extremely subjective, there are many disadvantages for the companies getting an modified opinion even if they are in the position to escape bankrupt situation and that there is hardly a real connection between the bankruptcy decision and the unmodified opinion of the financial auditors.

Thus, *M. A. Geiger and K. Raghunandan (2002)* demonstrated that changes in the litigation environment are associated with the issuance of fewer going-concern-modified opinions to stressed companies in recent years. This finding is consistent with the SEC's claim that auditors' behavior in recent years has been influenced by reduced litigation pressures.

On the same idea *Marshall A. Geiger, K. Raghunandan, and Dasaratha V. Rama (2005)* found that auditors are more likely to issue going-concern modified audit opinions in the period after December 2001 when Sarbanes-Oxley Act was issued.
Andrew J. Rosman, (2011) documented that auditors are adaptive in ill-structured tasks and rigid in structured tasks as predicted by theory. We can easily notice a real subjectivism in the financial auditors' activity with the respect of a new and stronger regulation or for a litigation atmosphere.
An analysis realized by *Alnoor Bhimani, Mohamed Azzim Gulamhussen,Samuel Lopes (2009)* shows that the risk for entities to reach bankruptcy is much higher when receiving an modified going concern opinion. At the same time it is acknowledged that the performance of the auditors in predicting the bankruptcy is much inferior to that of the risk models: *Alnoor Bhimani,Mohamed Azzim Gulamhussen, Samuel Lopes (2003)*, *P.Cybinski (2005)*
A certain independence of decision for bankruptcy from going concern modified opinion is also documented by *Alnoor Bhimani andCo. (2009)* and by *Marshall A. Geiger, K. Raghunandan, and Dasaratha V. Rama (2005)*
We think the results of our investigations along with the above evidence of the effectiveness of going concern opinion entitle us to look for a better way to use the concept of "going concern".

Conclusions
Relying on the evidence above shown we conclude that a separate or off-audit mission could be performed at the shareholders demand. It might appear too courageous to go for such a proposal but I think in this way a going concern opinion would be much more professional (it appears possible for experts to be involved in the audit process, using the statistical and mathematical models) and more close to the reality. On this purpose the content of the concept of going concern should be changed correspondently. The ISA standard of Going Concern should be adapted concerning the period of "twelve months" and the obligation for auditors to produce a going concern opinion at every engagement as well. From these changes would mainly take advantages the auditors, management representatives and shareholders.
More relevant data will enable us to more deeply argument this proposal. The future researches will be headed toward the improvement of the concept of going concern and, correspondently, the necessary adaptation of the financial audit standards.

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