

Title: *Auditing Going Concern Uncertainty*

Subtitle: *A Review of Global Research on Auditor Going Concern Reporting*

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**ABSTRACT:**

There has been a surge in recent research examining the auditor's going concern opinion (GCO) decision. In this study we adopt the GCO reporting model presented by Carson, Fargher, Geiger, Lennox, Raghunandan and Willekens (2013) and review the recent GCO research in the broad categories of examining the determinants of GCOs, research assessing the accuracy of GCOs, and research on the consequences of GCOs. Our study updates and extends the review presented by Carson et al. (2013) by synthesizing the research published or available since the end of their review through September 2019. We conclude our review with a discussion of salient findings of the research for this period and of the methodological issues identified in the literature. We then present a discussion of avenues for future research.

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## 1 Introduction

Reporting on going-concern-related uncertainties remains one of the most challenging issues faced by external auditors. Even though professional standards do not hold external auditors responsible for predicting future events, such as the subsequent viability of audit clients, if an auditor refrains from issuing a going concern modified audit opinion (hereafter GCO) and the client company subsequently fails (referred to in the academic literature as a “type II” reporting error<sup>1</sup>), the costs to the auditor in terms of increased litigation costs and loss of reputation are often substantial (Carcello and Palmrose 1994). At the same time, companies usually do not welcome a GCO from their auditor. For example, if an auditor renders a GCO to a financially distressed client, there is often concern that the GCO itself may precipitate, or at least accelerate, the financial distress of the already troubled company resulting in a self-fulfilling prophecy. Further, if an auditor renders a GCO to a client that subsequently survives (referred to in the academic literature as a “type I” reporting error), these clients are significantly more likely to switch to another auditor for their next audit (Geiger, Raghunandan and Rama 1998). It is not surprising, then, that audit

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<sup>1</sup> Professional auditing standards across the globe require an auditor to assess whether, in their professional judgement, they believe there is “significant” or “substantial” doubt about the client company’s ability to continue as a going concern for a reasonable period beyond the date of the financial statements. If the auditor maintains “significant” or “substantial” doubt about the client company’s ability to continue as a going concern, then professional standards require them to communicate such doubt as part of their audit report (i.e., render a GCO). Professional auditing standards have never required external auditors to predict the future viability of a financially or operationally distressed client. Nonetheless, academic research has referred to instances where an auditor issues a GCO and the company remains viable as a “type I” reporting error, and cases where a company is no longer viable but the auditor did not previously issue a GCO as a “type II” reporting error. To be consistent with the research included in our review, we use the type I error and type II error terminology, even though these instances are not a reporting “error” on the part of auditors.

practitioners, regulators and standard-setters around the world continue to grapple with this complex issue.<sup>2</sup>

In this study, we review and discuss the recent academic literature pertinent to the auditor's decision to issue, or not issue, a GCO. Our review begins with research available after the going-concern research synthesis provided in Carson, Fargher, Geiger, Lennox, Raghunandan and Willekens (2013). We attempt to minimize the gap and the overlap in the research discussed in Carson et al. (2013) and our work. Further, in an attempt to be as comprehensive as possible, we do not limit our coverage to only published research, but also include well-developed working papers in the public domain, particularly if we determine they add significant contribution to the literature. In order for our review to provide a consistent categorization of the main issues explored in the recent literature, we adopt the GCO reporting framework presented by Carson et al. (2013) and reproduced in Figure 1. Accordingly, our review categorizes research into studies that: (1) examine the determinants of GCOs, (2) assess the accuracy of GCO reporting decisions, and (3) examine the consequences of GCOs. We attempt to minimize multiple categorizations of studies by discussing them in the section reflecting the primary focus of the research, as determined by the respective authors' framing of the issues, events and associations examined. Nevertheless, there remain studies discussed in multiple sections of our review.

Insert Figure 1 Here

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<sup>2</sup> In fact, the International Auditing and Assurance Standards Board (IAASB) and Financial Reporting Council (FRC) have recently updated their standards concerning going concern and the Public Company Accounting Oversight Board (PCAOB) has a project on their current standard-setting agenda to address auditor responsibilities for assessing and reporting on going concern uncertainties. Additionally, an ongoing issue will be how auditors utilize the newly expanded auditor's report to communicate issues relating to going concern uncertainties and the GCO itself, and whether any differences are driven by professional standards, firm practices or cultural norms. We address these issues in the Future Research section.

We examine the literature on GCOs beginning with some of the studies in 2012 that were not included in the Carson et al. (2013) review, and conclude with studies that were published or included in the public domain through 30 September 2019. Specifically, we search accounting and auditing journals (see Appendix 1 for the list of journals) and SSRN for research published or posted from 1 January 2012 to 30 September 2019 for articles having the search terms “going concern or “going-concern” anywhere in the article. We find that the number of studies addressing GCOs issues has increased substantially since the Carson et al. (2013) review as we initially identify over 200 articles and well-developed working papers that examined or used GCOs in some manner. We then excluded studies that do not focus their analysis on GCOs in a meaningful way, or use GCOs merely as a control factor without providing any additional discussion or analysis. After this exclusion, 172 research papers remain and are included in our review. Table 1 summarizes the research papers by year and research method.

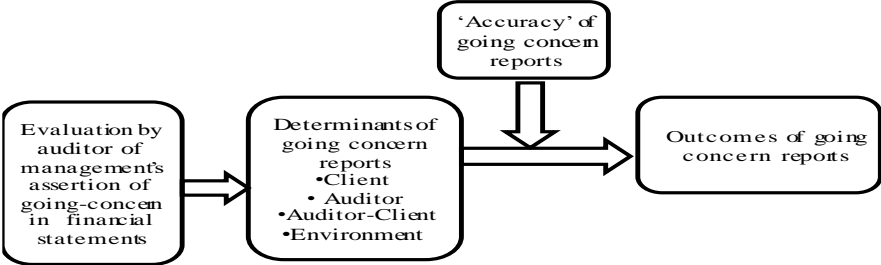
Insert Table 1 Here

Insert Appendix 1 Here

## **Appendix 1: List of Journals Searched**

*Abacus*  
*Accounting & Finance*  
*Accounting and Business Research*  
*Accounting and the Public Interest*  
*Accounting Horizons*  
*Accounting, Auditing and Accountability Journal*  
*Accounting, Organizations & Society*  
*Advances in Accounting*  
*Asia Pacific Journal of Accounting and Economics*  
*Auditing: A Journal of Practice and Theory*  
*Australian Accounting Review*  
*Behavioral Research in Accounting*  
*British Accounting Review*  
*Contemporary Accounting Research*  
*Critical Perspectives on Accounting*  
*Current Issues in Auditing*  
*Decision Sciences*  
*European Accounting Review*  
*International Journal of Auditing*  
*Journal of Accountancy*  
*Journal of Accounting & Public Policy*  
*Journal of Accounting & Economics*  
*Journal of Accounting Literature*  
*Journal of Accounting Research*  
*Journal of Accounting, Auditing & Finance*  
*Journal of Business, Finance & Accounting*  
*Journal of Contemporary Accounting & Economics*  
*Journal of Governmental & Nonprofit Accounting*  
*Journal of International Accounting Research*  
*Journal of International Accounting, Auditing & Taxation*  
*Maandblad voor Accountancy en Bedrijfseconomie*  
*Managerial Auditing Journal*  
*Procedia Economics and Finance*  
*Research in Accounting Regulation*  
*Review of Accounting and Finance*  
*Review of Accounting Studies*  
*Review of Quantitative Finance and Accounting*  
*The Accounting Review*  
*The International Journal of Accounting*

**Figure 1: Audit Reporting of Going-Concern Uncertainty Research Framework**



As reported in Carson et al. (2013).

**Table 1: Distribution of GCO Studies by Year and Research Method**

<u>Year of Publication*</u>	<u>No. of studies</u>	<u>Research Method</u>			
		<u>Archival</u>	<u>Experimental</u>	<u>Survey</u>	<u>Analytical</u>
2010	1	1	-	-	-
2011	2	1	1	-	-
2012	9	9	-	-	-
2013	22	20	1	1	-
2014	13	11	2	-	-
2015	23	21	2	-	-
2016	28	24	-	4	-
2017	37	33	3	-	1
2018	17	15	2	-	-
2019	20	18	1	1	-
Total	172	153	12	6	1

\*Based on year of publication or latest posted version for working papers, through September 2019.



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