Robyn Moroney
Professor and Head of Department (Accounting)
RMIT

GPO Box 2476
Melbourne VIC 3001
Australia

The IAASB has proposed a revision to ISA 570 (Revised) *Going Concern*. The aim is to promote consistent practice and behaviour when identifying risks of material misstatement related to going concern (GC), strengthen the auditor's evaluation of management's assessment of GC and enhance transparency with respect to the auditor's responsibilities and work related to GC, including strengthening communications and reporting requirements.

The focus of the research outlined in the attached report is in relation to the third aim.

As a team, we (Dr SY Phang, Dr TC Huang and me) have worked on a number of projects related to GC. I have also worked on projects with other collaborators in the past and we have supervised a PhD student who has looked at GC reporting. The attached report, submitted to CPA Australia, who funded this project, outlines work we have completed to understand how the proposed changes to the reporting of GC in the audit report may impact investors' decision making. We ran two experiments using experienced investors as participants to better understand how the updated clean opinion (i.e., the inclusion of a generic paragraph on going concern in all audit reports) may impact investors and then how changes in reporting Material Uncertainties Related to Going Concern (MURGC) may affect investors.

We believe that any proposed changes to GC disclosures in the audit report, should also consider how changes to the note disclosure by company management may also affect investors. In our second experiment that looks at changes to MURGC reporting, we include potential changes to the way that management may report the same type of information in the notes to the financial statements.

In developing our experimental materials, we used the format proposed in the IAASB's Exposure Draft on ISA 570 (Revised) *Going Concern* and excerpts of company financial statements and drew on the advice of staff at the AUASB and the AASB. This meant that our experimental materials reflected practice.

In our first experiment, we compared investor responses when an audit report that is unqualified and unmodified is in the current format or in the new format. Investors responded about the same on most questions asked (detailed in the report) but interestingly, reported that they had fairer warning when told the company had subsequently closed down, when they had received an audit report in the new format compared to those that received the audit report in the current format. A greater concern is how investors will read/take note of close calls under the same "Going Concern" heading (i.e., when there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, but do not give rise to a material uncertainty) in the future after becoming accustomed to reading a GC paragraph that says everything is fine. That is, there is a risk that when seeing the heading Going Concern, they will not read on, assuming that it is the usual boilerplate disclosure.

In our second experiment, we compared investor responses when an audit report included a MURGC in the current or the proposed format (i.e., including a description of how the auditor evaluated management's assessment). We also varied whether management included no commentary in their notes on the issue of focus in the MURGC. Investors either received no management commentary, commentary that uses soft language or commentary that uses strong language. We find that when comparing the two MURGC formats, investors respond much the same way. That means that changing the way MURGC is reported won't change investor views on the questions asked in our experiment (listed on page 6).

We find that management commentary on the issue discussed in the MURGC does make a difference. When management include some commentary, investors perceive the likelihood the company will remain in operation, return to profit and pay off its debts is lower than when no commentary is included. They also perceive that their investment in the company is riskier and less attractive when commentary is included. This means that investors take note when management include commentary on issues that place their investment at risk of no longer remaining a GC.

We find that the tone (soft versus strong) used in the management commentary impacts how investors feel about the reliability of that information, with investors perceiving that management are more reliable when the commentary is strongly worded than when it is softly worded.

Finally, we included a version of the audit report with a significant doubt disclosure (i.e., when there are events or conditions that may cast significant doubt on the entity's ability to remain a going concern but does not give rise to a material uncertainty). Prior research conducted by one of our PhD students showed that investors respond very differently when presented with the same GC information in a MURGC versus a Key Audit Matter (KAM), suggesting that they appropriately differentiate between the two disclosures. As the new significant doubt disclosure replaces the use of KAMs to report on GC issues investigated by the auditor, but not warranting inclusion in a MURGC, we were interested to see whether there is a significant difference in the way investors respond to a MURGC and to much the same information included as a significant doubt disclosure. We find no difference in the way investors responded to the questions asked when the GC disclosure was included in a MURGC or as a significant doubt, using the proposed new format. This means that investors appear to no longer be able to distinguish between what it means when an auditor decides to disclose an issue as a MURGC or to use a disclosure indicative of a less serious issue.

Robyn Moroney

RMoroney

Professor

RMIT University

Going Concern
Exposure Draft

Ting-Chiao Huang
Robyn Moroney
Soon-Yeow Phang

Report for CPA Australia

Grant 34891:
Emerging Disclosures: Exploring the Potential Impact of
Parliamentary Joint Committee Inquiry Recommendations on Investors' Perceptions

Research Questions

The issue of going concern (GC) reporting and the form it should take is an important one. The assessment of GC uncertainty is the responsibility of both management and auditor. When preparing their financial report, management is responsible for assessing the appropriateness of the GC assumption. This assertion is then subsequently evaluated by the auditor. We are interested in whether investors can differentiate between different GC reporting and appreciate the varying GC disclosure by management.

Research Design

We conducted two experiments to understand how investors may respond to proposed changes in GC reporting and how they might respond to additional disclosure around GC by management.

In our *first experiment* we provided participants a profit and loss and balance sheet and then a clean audit opinion in the current format or in the proposed format (illustration 2 in the exposure draft), which includes a section that explains how the auditor has considered the GC status of the company.

Clean audit report format	Current	New
	n=91	n=89

n=number of participants (total 180)
Age – ranged from 20s to 60+ average in their 30s
Gender – 63% Male
Work experience – average of 18 years
Investment experience – average of 8.5 years

In our *second experiment* we provided participants a profit and loss and balance sheet. They then received notes to the financial statement and an audit report. The note included either, no additional information from management, some additional information regarding GC using either soft or strong wording. The audit report included a Material Uncertainty Regarding GC (MURGC) section in either the current or proposed format (illustration 4 in the exposure draft). For completeness we also included a version where the audit report included a discussion of GC being a significant doubt, like the way Key Audit Matters (KAMs) are currently used when a MURGC is deemed to be inappropriate.

	No additional	Soft additional	Strong additional
MURGC Current	n=105	n=101	n=96
MURGC New	n=100	n=91	n=105

An additional group received a significant doubt disclosure in their audit report (no additional information from management in the notes) n=104

n=number of participants (total702)
Age – ranged from 20s to 60+ average in 30s
Gender – 66% Male
Work experience – average of 19 years
Investment experience – average of 9 years

When management did not add any additional information, the note only included a table with numbers, which the auditor refers to in their GC discussion in the audit report. When management added additional information regarding GC, the wording was either 'soft' or 'strong'. Please see below for the wording used.

Soft:

1.k. Going concern basis of accounting

The financial statements have been prepared on a going concern basis, which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business. However, during the year ended 31 December 2022, the Company experienced a significant reduction in revenue because of an economic downturn, recorded a net comprehensive loss of $1,034,000. While the Company had cash on hand of $1,311,000, net assets of $7,158,000 and current assets which exceeded current liabilities by $4,789,000, there are concerns that it may not be able to make the required repayments under its debt facilities to comply with its debt covenants.

And under the table:

At the reporting date, Accell's financial statements include Deferred Tax Assets with a value of $3,808,000. Determining income tax provisions involves judgment on the tax treatment of certain transactions. Deferred tax is recognized on tax losses not yet used and on temporary differences where it is probable that there will be taxable profit against which these can be offset. The Directors have made judgments as to the probability of future taxable profits being generated against which tax losses will be available for offset.

Strong:

1.k. Material Uncertainty regarding the going concern basis of accounting

The financial statements have been prepared on a going concern basis, which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business. However, during the year ended 31 December 2022, the Company experienced a significant reduction in revenue because of an economic downturn, recorded a net comprehensive loss of $1,034,000. While the Company had cash on hand of $1,311,000, net assets of $7,158,000 and current assets which exceeded current liabilities by $4,789,000, there are concerns that it may not be able to make the required repayments under its debt facilities to comply with its debt covenants. This means that there is a material uncertainty whether the Company will be able to realize its assets and discharge its liabilities in the normal course of business.

And under the table:

At the reporting date, Accell's financial statements include Deferred Tax Assets with a value of $3,808,000. Determining income tax provisions involves judgment on the tax treatment of certain transactions. Deferred tax is recognized on tax losses not yet used and on temporary differences where it is probable that there will be taxable profit against which these can be offset. The Directors have made judgments as to the probability of future taxable profits being generated against which tax losses will be available for offset.

Note: In developing both experiments, we drew heavily on the expertise of staff at the AUASB and the AASB. We also consulted with experts in practice.

We asked the participants the following questions to evaluate whether different GC reporting and management GC disclosure affect investors' assessment of a company's GC status.

Questions – responses were on an 11-point scale

In your opinion, what is the likelihood that Accell will remain in operation over the next 12 months?
In your opinion, what is the likelihood that Accell will return to profitability over the next 12 months?
In your opinion, what is the likelihood that Accell will be able to service its existing debt?
How risky is an investment in Accell?
How attractive is an investment in Accell?
How likely are you to retain your investment in Accell's shares (keep your shares)?
How reliable is the information provided by Accell's management in the financial statement?
How confident are you in Accell's management?
Based on the information provided in the case materials, how credible is Accell's management?
How reliable is the information provided by Accell's auditor in the audit report?
How confident are you in Accell's auditor?
Please rate the extent to which you agree the auditors conducted a good quality audit.

Participants were then told:

You have just learned that Accell is closing down as they cannot pay their debts. You have made a significant loss on your investment in Accell.

We then asked participants the following questions to evaluate whether different GC reporting and management GC disclosure affect investors' perceptions on whether the audit report and the notes to the financial report provide fair warning on a company's GC status.

Do you believe that the information included in the audit report regarding Accell's capacity to remain a going concern gave you fair warning that they could close down this year?
Do you believe that the information included in the notes to the financial report gave you fair warning that Accell could close down this year?

Findings

First experiment – clean audit opinion – new v current format

The first experiment compares new format (illustration 2) with current format when a clean audit opinion is issued. The table below summarises the results of our t-tests comparing new and current.

S = significant NS = not significant

Likelihood that Accell will remain in operation over the next 12 months?	NS
Likelihood that Accell will return to profitability over the next 12 months?	NS
Likelihood that Accell will be able to service its existing debt?	NS
How risky is an investment in Accell?	NS
How attractive is an investment in Accell?	NS
How likely are you to retain your investment in Accell?	NS
How reliable is the information provided by Accell's management?	NS
How confident are you in Accell's management?	S*
How credible is Accell's management?	NS
How reliable is the information provided by Accell's auditor?	NS
How confident are you in Accell's auditor?	NS
Please rate the extent you agree the auditors conducted a good quality audit.	NS
Fair warning audit report	S**
Fair warning financial report	S**

*More confident when new audit report format used

**Rated warning fairer when new audit report format used (note no difference is financial report details provided across the two groups)

Second experiment – MURGC – new v current format

The second experiment compares new format (illustration 4) with current format when a MRUGC is issued. The table below summarises the results of our t-tests comparing new and current.

S = significant NS = not significant

Likelihood that Accell will remain in operation over the next 12 months?	NS
Likelihood that Accell will return to profitability over the next 12 months?	NS
Likelihood that Accell will be able to service its existing debt?	NS
How risky is an investment in Accell?	NS
How attractive is an investment in Accell?	NS
How likely are you to retain your investment in Accell?	NS
How reliable is the information provided by Accell’s management?	NS
How confident are you in Accell’s management?	NS
How credible is Accell’s management?	NS
How reliable is the information provided by Accell’s auditor?	NS
How confident are you in Accell’s auditor?	NS
Please rate the extent you agree the auditors conducted a good quality audit.	NS
Fair warning audit report	NS
Fair warning financial report	NS

No significant difference in any responses – the new format does not impact investor responses.

Second experiment – additional information re GC included in the notes – included or not included.

The second experiment also compares the situation where additional GC disclosure by management is included in the notes and the situation where such disclosure is not included. The table below summarises the results of our t-tests comparing included and not included.

S = significant NS = not significant

Likelihood that Accell will remain in operation over the next 12 months?	S
Likelihood that Accell will return to profitability over the next 12 months?	S
Likelihood that Accell will be able to service its existing debt?	S
How risky is an investment in Accell?	S
How attractive is an investment in Accell?	S
How likely are you to retain your investment in Accell?	NS
How reliable is the information provided by Accell's management?	NS
How confident are you in Accell's management?	NS
How credible is Accell's management?	NS
How reliable is the information provided by Accell's auditor?	NS
How confident are you in Accell's auditor?	NS
Please rate the extent you agree the auditors conducted a good quality audit.	NS
Fair warning audit report	S
Fair warning financial report	S

When management include wording in the notes regarding GC it has this effect (when compared to no wording included):

Likelihood of remaining in operation, returning to profit, and paying of its debts assessed as lower.

Investment is assessed as more risky and less attractive.

Fair warning assessed as greater.

Second experiment – additional information re GC included in the notes – soft v strong language.

We further compare whether the language used by management in the additional GC disclosure impacts investors. The table below summarises the results of our t-tests comparing soft and strong language used in the additional information.

S = significant NS = not significant

Likelihood that Accell will remain in operation over the next 12 months?	NS
Likelihood that Accell will return to profitability over the next 12 months?	NS
Likelihood that Accell will be able to service its existing debt?	NS
How risky is an investment in Accell?	NS
How attractive is an investment in Accell?	NS
How likely are you to retain your investment in Accell?	S
How reliable is the information provided by Accell's management?	S
How confident are you in Accell's management?	NS
How credible is Accell's management?	NS
How reliable is the information provided by Accell's auditor?	NS
How confident are you in Accell's auditor?	NS
Please rate the extent you agree the auditors conducted a good quality audit.	NS
Fair warning audit report	NS
Fair warning financial report	NS

When management include strong wording in the notes regarding GC it has this effect (when compared to soft wording included):

Investors were more likely to retain their shares.

Investors assessed the information provided by management as more reliable.

Second experiment – significant doubt v MURGC (no additional information in the notes).

Last, we compare the situation where a significant doubt is reported and the situation where a MURGC is reported. The table below summarises the results of our t-tests comparing an audit report with a significant doubt disclosure with and audit report with a MURGC – with no additional information provided in the notes.

S = significant NS = not significant

Likelihood that Accell will remain in operation over the next 12 months?	NS
Likelihood that Accell will return to profitability over the next 12 months?	NS
Likelihood that Accell will be able to service its existing debt?	NS
How risky is an investment in Accell?	NS
How attractive is an investment in Accell?	NS
How likely are you to retain your investment in Accell?	NS
How reliable is the information provided by Accell’s management?	NS
How confident are you in Accell’s management?	NS
How credible is Accell’s management?	NS
How reliable is the information provided by Accell’s auditor?	NS
How confident are you in Accell’s auditor?	NS
Please rate the extent you agree the auditors conducted a good quality audit.	NS
Fair warning audit report	NS
Fair warning financial report	NS

This finding is of interest as Rebecca Mattock’s research shows that investors react differently to a MURGC and a KAM, containing the same information in a different format. By moving from a KAM to a discussion of a significant doubt under the GC heading, it is seen as the same as a MURGC disclosure under the same heading.