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Sandro Brunelli

# Audit Reporting for Going Concern Uncertainty

Global Trends and the Case Study of Italy

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*To People Who Raised Me*

# Foreword

Transformation and uncertainty are the two main words used to describe the current economic environment. What was impossible and unpredictable just few years ago is now under the eyes of everyone.

The world is changing at the speed of light, much more rapidly than in the past. What next is almost impossible to predict.

Nowadays, a child has virtually the knowledge of the world in his palms but a Board may have troubles to understand the evolutions to come and making plans can be something like a guessing game. Especially when the firm's life is at stake and its continuity has a going concern as a risk.

At the same time, the long financial crisis has shaken business sectors globally and its end has been wrongly predicted many times along these years. Again, uncertainty becomes the lite motive of the business life, bankruptcies increase and the going concern issues became more difficult to predict.

The going concern represents one of the most important underlying assumptions for preparing financial statements and it is fundamental that stakeholders can trust that both Board of Directors and Auditors have and use all the possible instruments to properly address and communicate the ability of a company to continue its life in a sustainable way.

The role of the auditors is both difficult and fundamental in this environment and Prof. Sandro Brunelli offers us a ticket for an interesting global trip to understand how Audit Reporting for Going Concern Uncertainty is addressed in different jurisdictions and how it will change in the future to improve the financial reporting to benefit stakeholder' companies worldwide.

At the end of the journey, some open points remain to be addressed by future studies. For instance, in terms of impact and reaction of Going Concern Opinions on different stakeholders categories. This book gives the reader (graduate, scholars, regulators, auditors) a complete picture of the state of the art of this fundamental issue for financial reporting globally.

Rome, Italy

Giovanni Poggio  
PWC Italy Partner

# Preface

The interest in writing a book related to Audit Reporting for Going Concern Uncertainty (GCU) has grown in me since the middle of 2016.

At that time, I started, with a colleague in Tor Vergata and the other two from other Roman universities, a wide research project aimed at feeding the debate about the investor's reaction to and perception of the so-called Going Concern Opinions (GCOs). I discovered a world in terms of literature, regulation, auditing and accounting practices, approaches and ways to detect the effects of GCOs on the entire stakeholder plethora. Thus, even though research papers are welcome, an in-depth analysis in the form of a dedicated book seems suitable as well.

Currently, the picture of Audit Reporting for GCU is huge and includes plenty of studies. In the USA, the Public Company Accounting Oversight Board (PCAOB), the auditing standards setter, has recently proposed the Going Concern (GC) as a next action under consideration; in Europe, the International Auditing and Assurance Standards Board (IAASB) has made an extensive revision of several auditing standards including the International Auditing Standards (ISA) 570—Going Concern.

At the same time, the GC represents worldwide an important underlying assumption for the preparation of financial statements—perhaps, the most important.

The Financial Accounting Standards Board (FASB) issued on 27 August 2014, the 'Accounting Standards Update No. 2014–15, *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*'. It constitutes an amendment to the standard provided by the FASB, in November 1978, 'Original Pronouncements as amended, *Statement of Financial Accounting Concepts No.1*. In the European context, the International Accounting Standards Board (IASB) did not provide a specific standard for GC because of its explicit nature of underlying assumption within the Conceptual Framework. Indeed, GC is treated only in the '*Conceptual Framework for Financial Reporting*', for which the last update was released in 2010 even though the framework, for other reasons, is currently under review. In brief, we are assisting to a reverse evidence for what concerns the GC and its links with accounting and auditing standards: On one hand, the 'auditing regulation' has been updated and reinforced on the European side; on the other hand, the

‘accounting regulation’ has been updated and reinforced on the American side. Thus, with regard to GC updating, PCAOB is a follower of the IAASB and IASB is a follower of the FASB. Above all, one question arises: Is it right to talk about leaders and followers in enhancing the overall quality of financial reporting worldwide? Obviously, the answer is no. However, more than this, it is interesting to investigate reasons behind these reversals and how, by also taking into account evidence from other jurisdictions, Audit Reporting for GCU will be addressed in the next years with the aim of enhancing the financial reporting system’s reliability and usefulness for stakeholders.

This book is an attempt to outline the state of the art, by reviewing the main studies in this specific area using a narrative approach and providing some interesting empirical evidence from the Italian Stock Market by drawing out how investors react over time to GCOs. The aim is to enhance the quality of the debate by joining academic literature, standard setters’ behaviours and empirical evidence, and taking into account the well-known existing international differences in financial reporting.

The book is divided into four chapters:

- Chapter 1 has a twofold aim: First, it simply reviews GC as an underlying assumption for the preparation of financial statements. It outlines GC’s history in the accounting standards and how it is currently considered in the FASB and IASB accounting standards. Second, the same reasoning will be referred to the auditing field addressing how auditors in PCAOB and IAASB environments should verify the GC’s presence in financial statements and what they outline as regards the audit report. In addition, accounting and auditing regulation insights related to GC in other jurisdictions will be shortly touched upon.
- Chapter 2 covers the heart of the issue. Starting from the seminal work led in the USA by Carson et al. (2013), the chapter reviews, with a narrative analytical approach, the debate related to Audit Reporting for GCU worldwide. In this regard, I decided to adopt for the same categorization as Carson et al. Thus, the researches on the theme will be reviewed by treating separately the determinants, accuracy and consequences of GCOs. Studies conducted in the USA, Europe and the rest of the world will be reviewed separately.
- Chapter 3 enriches the work with interesting empirical evidence from the Italian Stock Market. To this end, I will show how, in the period from 2008–2014, alongside the financial crisis, Italian investors reacted to GCOs, using the Event Study Methodology (ES). The results will be interpreted under different investigation profiles.
- Chapter 4, recovering the evidence found in the previous chapters, concludes the book by looking at a series of open issues, such as:
  - the reflections of GCOs in the light of agency theory;
  - how to read auditing rules for GCU and investors’ reactions in the light of different country culture types deriving from international differences in financial reporting;



- Possible future Italian investors' behaviours, since novelties for periods ending on or after 15 December 2016 of several ISAs (above all the ISA 570 revised) foster, more than in the past, the release of a GCO;
- Whether and how auditing standard setters will implement fine-tuning actions or update auditing standards related to GCU;
- How scholars will feed the debate of Audit Reporting for GCU.

The reading of this book should be suitable for:

1. Graduates, to go into more depth in their study of auditing and financial reporting as a whole. Mainly for courses included in Master's of Science in Business Administration (or strictly related Master's programmes);
2. Scholars active in research projects in the field: First, to provide a structured general framework on audit reporting for GCU; second, to suggest future research pathways;
3. Regulators, I mainly refer to auditing standards setters and to have an overview of the state of the art worldwide;
4. Auditors, to enrich and enhance the debate around the issue, to foster an improvement of their internal procedure for releasing, or not, a GCO and, more in depth, to understand the importance of GCOs for stakeholders.

Rome, Italy

Sandro Brunelli

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