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# Audit reporting for going concern in Spain during the global financial crisis

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## ABSTRACT

The current world financial crisis is causing real difficulties in the operation of firms and has generated renewed interest in audit reports. This study aims to analyse the impact of the financial crisis on the audit reports issued by auditors. We focus especially on those reports that contain questions relating to going concern situations. The sample analysed is formed by 2935 audit reports of unlisted Spanish firms for the years 2007–2010. From the results obtained we can affirm that the crisis being suffered by Spanish firms has not gone unnoticed by audit professionals. Our research reveals that as the crisis in Spain has worsened, the proportion of reports that include references to going concern situations has increased in comparison with 2007, when the financial crisis had not become manifest in Spain. The sectors of the Spanish economy most affected by the crisis are real estate and construction. Taking into account whether the audit firm issuing the report is Big-4 or Non-Big-4, no significant differences can be appreciated in the percentage of reports issued with going concern qualifications before the start of the crisis (2007) and during the crisis (2008–2010).

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Going concern; financial crisis; audit reports; unlisted companies

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## 1. Introduction

Audit reports are the means by which the auditor makes known to the various users of the information the financial problems faced by firms, informing where appropriate on an entity's ability to continue as a going concern. The current world financial crisis is causing real difficulties in the operation of firms and has generated renewed interest in audit reports.

The international financial crisis, the effects of which were felt in Europe in 2008, has reached the present as a crisis of liquidity. The Spanish economy faces situations of lack of liquidity and short-term financing, high prices for certain imported goods and internal factors that cause a sharp drop in the activity of our economy. The Spanish economy was at the end of a cycle marked by economic growth, and by employment higher than that of the countries of the European Union, when the worldwide financial crisis started. All this was

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a result of the excessive prominence of the construction sector and the growing imbalances preventing the continuity of the expansive cycle. The growth model posited in this country was unstable, as shown by a higher rate of investment in construction, the deterioration of the rate of saving, the rapid growth of debt in families and in firms, a higher rate of inflation, and the stagnation of productivity.

The precariousness of Spain's economic progress could be seen clearly due to the magnitude and growth of the deficit. At an unfavourable time worldwide, the Spanish economy would have had to adjust independently of the international financial crisis, but the crisis was the trigger. As well as the general negative circumstances, Spain needed to adjust its foreign trade deficit; this is one of the reasons why the Spanish economy is suffering the international crisis with greater intensity.

The paralysis of bank credit, born of the distrust provoked by the financial crisis, is seriously affecting the real economy. This is an important problem, as the solvency and dynamism of the banking system is essential. Governments are aware that, because the crisis has affected the ordinary credit channel (the main source of finance for small and medium firms and families), the adjustments will be more intense and prolonged. Most sectors of the Spanish economy are suffering a serious crisis, the real estate and construction sector being one of those most affected (García-Delgado & Myro, 2011).

The objective of this paper is to analyse the impact of the current financial crisis through the content of audit reports, and especially for those reports with going concern situations. For this, we first describe and classify the different opinions contained in audit reports, making a distinction between those reports that contain a favourable opinion (unqualified opinion) and those that contain a qualified opinion, a disclaimer or an adverse opinion. Secondly, taking into account the opinion contained in the report we analyse its relationship with three factors: (i) the audit firm issuing the report, (ii) the existence of a change of auditor, and (iii) the sector of activity to which the firm belongs. The aim is to detect any relation between the opinion in the reports and these factors, placing special emphasis on those reports that present going concern situations. Finally, for the period 2009–2010, we have analysed the firms whose reports include mentions of going concern situations or not in 2009, and in 2010 do or do not enter bankruptcy proceedings. The sample analysed consists of 2935 audit reports of unlisted Spanish firms for the years 2007–2010.

Our paper contributes to the literature in two aspects. On the one hand, very few studies, in Spain or at an international level, examine audit reports from the start of the current financial crisis. On the other hand, the majority of the existing studies of audit reports are made for firms listed on the stock exchanges, as this information is easily accessible and costs the user nothing. Also, in the case of Spain most of the existing papers on unlisted firms (Alcarria, 1997; Caso, García, López, & Martínez, 2003; González-Bravo & Martín, 1999; Hernández & Vidal, 1998; López-Corrales, 1997; López-Díaz, Andrés, & Rodríguez, 2000; López-Díaz, Martínez-Arias, & García-Díez, 1997; Mareque, López-Corrales, & Fiestras, 2015; Medina, Hernández, & Hernández, 1997), contain an added problem: the sample used is not representative of all Spanish territory, but analyses certain parts of the territory (regions or provinces). This represents a clear limitation when interpreting their results, as they cannot be extrapolated to the national level.

In sum, studies are needed that analyse the audit reports of small and medium firms.<sup>1</sup> Small and medium firms form a very important part of countries' business fabric, especially

in the case of Spain, where they represent 99.88% of the currently existing firms (Ministry of Industry, Energy & Tourism, 2012).

From the results obtained in this study we can affirm that the crisis that Spanish firms are suffering does not pass unnoticed by auditing professionals. Our study reveals that as the crisis in Spain worsens, the proportion of reports that include going concern opinions increases in comparison with 2007, in which year the financial crisis had not manifested itself in Spain. Most sectors of the Spanish economy are going through a serious crisis, although the real estate and construction industries are the most affected. On the other hand, taking into account the audit firm issuing the report (Big-4 or Non-Big-4), no significant differences can be appreciated in the percentage of reports with a going concern opinion before the start of the crisis (2007) and during the crisis (2008–2010). Furthermore, in the first three years (2007–2009), auditors when mentioning the existence of going concern situations in the report opt to include them in qualification paragraphs and, in 2010, they do so in an emphasis paragraph.

The paper is structured as follows. After this introduction, Section 2 summarises the principal changes in Spanish regulations relating to the going concern audit standard, and highlights the renewed interest in audit reports in times of crisis. Subsequently, Section 3 reviews the literature on the evolution and impact of the current financial crisis through the content of audit reports, the principal motivation of the study. The sample and the methodology are set out in Section 4, and in the fifth, the main results are shown, ending with the final conclusions.

## 2. Going concern and the audit report in times of crisis

Spanish regulations indicate that the auditor, when issuing the audit report on a firm with going concern problems, must basically apply the provisions of the Standard on Auditing regarding the Auditor's Report (ICAC, 1991, 2010) and Standard on Auditing, Going Concern (ICAC, 1993). The auditor of accounts must pay attention to situations or circumstances that may cause doubt as to the continuity of the activity of the firm. If after analysing all these factors, substantial doubts persist, the uncertainty must be mentioned in the audit report in accordance with the existing regulations. The technical opinion that the auditor records in the report aims to lend greater reliability to the annual accounts. This opinion does not constitute a guarantee regarding the future viability of the firm. The auditor must pay attention to any circumstances that may cause doubt as to the continuity of the firm throughout the next financial year.

The Spanish Auditing Standard on the Auditor's Report has recently been modified to adapt it to international standards. This modification means that its application is compulsory for all audit reports issued from 1 January 2011 onwards. Spain, as a member country of the European Union (EU) has gradually adapted its regulations to the Directives issued by the European Parliament and the Council of Europe. The process of harmonisation of auditing in Europe began in 1984 with the publication of the Eighth Directive 84/253/CEE (EU, 1984). This Directive arose as a result of the changes in the economic and financial environment (increase in globalisation and internationalisation), and from the EU's need for greater harmonisation of auditing. This process of reform continued, giving rise in 2006 to the approval and publication of a new Eighth Directive (Directive 2006/43/CE; EU, 2006), relating to the legal auditing of annual and consolidated accounts. This new Eighth Directive

was an important step towards greater harmonisation among the countries of the EU. The objective of the new Eighth Directive was to require the application of a single group of auditing standards for all the member countries, the International Accounting Standards (ISA) issued by the International Federation of Accountants (IFAC). ISA 700 – Forming an Opinion and Reporting on Financial Statements (IAASB, 2009a), ISA 705 – Modifications to the Opinion in the Independent Auditor’s Report (IAASB, 2009b) and ISA 706 – Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report (IAASB, 2009c), constitute the international benchmark of standards regulating the performance of auditors in relation to the issue of the audit report.

The analysis of the reports that we present in our study covers a period of four years, from 2007 to 2010. We must take into account the change in the Spanish rules on the treatment of uncertainties as to continuity and their reflection in the audit report. Reports issued from 1 January 2011 onwards are written out applying the new Auditing Standard on reports<sup>2</sup> (ICAC, 2010). This new standard establishes that, provided all the information is included in the management report on the annual accounts, any significant uncertainty regarding continuity situations will be reflected in the auditor’s report by inclusion of an emphasis paragraph. This differs from the previous Spanish rules, under which such circumstances were written in uncertainty qualification paragraphs.

At present, the most frequent reason for issuing an audit report with uncertainties is because of doubts about the continuity of the firm. These uncertainties are a consequence of the lack of liquidity and of the deterioration of the economic development of the firms’ activities, together with the economic crisis that we are currently suffering in Spain. All these situations have led to many Spanish firms having a higher continuity risk.

The current World financial crisis has given rise to a significant increase in business failures and has generated renewed interest in audit reports for those clients with continuity problems. The themes of most concern are related with the problems of liquidity and credit starting in the years 2007–2008, and with the role played by auditors in alerting to these problems. These questions have aroused a series of consultations with the regulators on the efficacy of auditing at international level (see EU, 2010; House of Lords, 2011; Sharman Inquiry, 2011) with special interest in the auditor’s capacity to evaluate and report on a firm’s capacity to continue as a going concern.

In Europe, the financial crisis has caused the sufficiency of the community framework in matters of auditing of accounts to be questioned, the European Commission publishing in 2010 the Green Paper *Audit Policy: Lessons from the Crisis*, (EU, 2010). This document points out that reliable auditing is a key factor for regaining market confidence and that auditing, together with supervision and corporate governance, should contribute to financial stability, since the audit offers a guarantee of the veracity of the financial solidity of all firms.

The background of the Green Paper is clearly related to the financial crisis and seems to be a declaration of political intent with regard to the auditing profession. This document revolves round three fundamental ideas: (i) the audit market, (ii) the regulation of auditing and (iii) the auditor’s opinion. The Green Paper notes that auditors exercise ‘a social and public interest function, absolutely fundamental in a democratic economic and political system’, and underlines the importance of audit reports for interested third parties (investors, lenders, customers or suppliers). The Green Paper indicates that audit reports should be brief, with clear and concise conclusions, and that the possible incorporation of qualifications in audit reports should not be eliminated, since the qualifications contribute to the

quality of the financial information. Furthermore, the audit reports of financial institutions should include more precise divulgation requirements for the valuation of the less liquid assets, in order to permit comparison of the valuations of financial instruments between institutions (García-Benau, Zorio, & Novejarque, 2013).

### 3. Literature review

The literature reviewed by us and by other authors (Carson et al., 2012) shows the need for research into the content of audit reports in order to study the evolution and effects of the current financial crisis. In addition, the existing studies are based on data from firms listed on the stock exchanges or on data contained in databases such as Compustat or CRSP (DeFond, Raghunandan, & Subramanyam, 2002; Feldmann & Read, 2010; Kaplan & Williams, 2012). These databases contain mostly listed firms, excluding smaller firms for their analysis, hence the importance of the need for future research to study unlisted firms.

There are currently very few studies, either in Spain (Mareque, López-Corrales, & De Lima, 2012; Mareque, López-Corrales, & Pedrosa, 2011) or in other countries (Carson, Simnett, & Tronnes, 2011; Cheffers, Whalen, & Sielis, 2011; Cheffers, Whalen, & Thrun, 2010; Feldmann & Read, 2010; Xu, Carson, Fargher, & Jiang, 2013 and Xu, Jiang, Fargher, & Carson, 2011) that show the effect of the financial crisis on audit reports. A recent review by Carson et al. (2012) provides a synthesis of the existing academic literature on the presentation of reports containing problems of continuity. This review includes a series of studies in different countries relating to the analysis of audit reports in the first years of the financial crisis. Carson et al. show that there are very few academic studies of the financial crisis that we are currently suffering. It is therefore too soon for current studies to be able to identify the trends of opinions modified by going concern uncertainties in audit reports. Our paper should be considered a further contribution to the sparse studies existing.

In relation to the evolution of the issue of opinions modified by continuity uncertainties during the financial crisis, Cheffers et al. (2011) observe for the US Stock Exchange in the period 2000–2009, that these reports rise from a minimum of 14.4% for the year ending in 2003, to 21% for year ending 2008, falling to 19.4% in 2009. They also estimate that, in 2010, 18.5% of the total number of reports includes going concern uncertainty opinions. These authors analyse the causes identified in the opinions qualified by going concern concerns in the reports, the main ones being: Net/Operating Loss (including recurring losses), development stage, working capital/current ratio deficit/inadequacy, net losses since inception, accumulated/retained earnings deficit, absence of significant revenues, insufficient/limited cash, capital or liquidity concerns, negative cash flow from operations.

Carson et al. (2011), for the period 2002–2009, compare the rate of issue of qualified opinions due to continuity concerns for non-financial firms that made losses in the current year in the United States, United Kingdom, Australia, France and Germany. They observe that in the 2008 reports the rates of going concern qualifications increased compared with the previous year in all the countries, although this increase was more pronounced in the United Kingdom, Australia and Germany. In 2009, the results are uneven as, in the case of France, Germany and the United States the rate of going concern qualifications decreases, while the United Kingdom and Australia show a slight increase.

Other authors try to study what the relationship has been between the failure of the firm and the prior issue of a report modified by going concern uncertainties. Thus, Feldmann



and Read (2010) study whether the post-Enron conservatism persists or has vanished with time. They examine the audit opinion issued 12 months before a bankruptcy filing by 565 US firms in the period 2000–2008. Through the database BankruptcyData.com they identify the corporations that filed for bankruptcy from January 2000 to August 2008, eliminating financial services firms and firms without financial difficulties. In the period 2006–2007 they observe 63 bankruptcies, 51% of the audit reports having received a going concern qualification in the year before the bankruptcy, and for the period 2008–2009, they also observe another 63 bankruptcies, 52% of the audit reports obtaining a going-concern opinion in the year prior to the bankruptcy. Therefore, the rate of bankruptcies without prior issue of a going concern uncertainty opinion does not seem to have decreased notably during the period of financial crisis.

Xu et al. (2011, 2013) published two papers on firms listed on the Australian stock exchange. In the first, they make a descriptive study for a sample of 8382 firms, in order to examine the response by Australian auditors to the current world financial crisis. They analyse the frequency of the different types of audit reports, especially of those reports relating to the increase in going concern questions. The result of their analysis indicates that during the period analysed the proportion of audit reports with going concern qualifications increase. The rates of modification increase from 12% in 2005–2007 to 18% in 2008 and 22% in 2009. Furthermore, firms belonging to the financial sector, the materials sector, and the industrial sector received the most qualified reports. In relation to the audit firm, they study whether there are any differences between the increase in the reports issued by the Big-4 and the Non-Big-4, concluding that both types of auditor increase the frequency of issue of reports with going concern qualifications if the period 2008–2009 is compared with 2005–2007.

In the second paper, Xu et al. (2013) examine the impact of the global financial crisis on auditor behaviour in Australia. Using a sample of listed companies, they examine whether the global financial crisis has impacted the propensity of auditors to issue going concern qualifications, and whether it has increased audit effort as reflected in audit fees and audit reporting lag. They find an increase in the propensity to issue going concern opinions during the period 2008–2009 compared with the period 2005–2007 and that Big-N auditors responded to the global financial crisis earlier than Non-Big-N auditors. In relation to audit effort, they find evidence of higher audit fees during the period 2008–2009 than in 2005–2007. There is, however, no evidence of increased audit reporting lags during the global financial crisis. Overall, they find evidence that auditors respond conservatively to protect themselves from higher risk exposure during the GFC by both increasing their propensity to issue going concern opinions and expending additional audit effort.

In Spain, Mareque et al. (2011, 2012) carried out two studies. The first, to analyse what kind of financial-crisis-related qualifications are contained in a sample of audit reports on companies listed on the secondary market of the Spanish stock exchange for the period 2007–2009. They analyse empirically the references to the financial crisis and its relationship with certain descriptive factors of the characteristics of the firm (audit firm and industry). The results of the study imply that the financial crisis is reflected in the reports by means of uncertainty qualification paragraphs, the auditor registering in these paragraphs the firm's continuity problems. The doubts as to the capacity to continue as a going concern will depend on certain factors, such as fulfilment of the viability plan, approval of the agreement with creditors, the realisation of its assets and the liquidation of its liabilities, the obtaining

of syndicated loans, etc. They conclude that the proportion of reports with references to the financial crisis is not maintained throughout the period analysed. In addition, the references to the crisis in the reports bear no relation to the audit firm issuing the report. With reference to sectors, except in 2007, in the other two years analysed (2008–2009), there is a relationship between the references to the financial crisis included in the reports and the sector to which the firms belong, the real estate sector presenting a higher percentage of references to the financial crisis in the reports.

Later, Mareque et al. (2012) carried out another study of the content of the reports issued for a sample of firms traded on the Spanish and Portuguese continuous market for the years 2007–2009. They analyse how auditors reflect the financial crisis in the reports, and its relationship with other factors such as: the sector, the audit firm and the type of opinion contained in the report. They conclude that the financial crisis lashing Spanish and Portuguese firms does not escape the notice of the audit professionals of the two countries. The auditors record in their audit reports various paragraphs relating to the continuity situations faced by the firm. Firms' capacity to continue as a going concern will depend on factors such as: fulfilment of a viability plan, approval of the agreement with creditors, realisation of its assets and liquidation of its liabilities, the obtaining of syndicated loans, etc. Auditors include the references to the financial crisis in their reports, mostly by means of uncertainty qualification paragraphs. In Portugal, auditors include references to the financial crisis in their reports by means of emphasis paragraphs. For the case of Spain, it is the real estate sector that contains proportionately more references to the financial crisis; in Portugal, on the other hand, it is the commerce and other services sector. Finally, we observe that in both countries the Big-4 include proportionately more references to the financial crisis in their reports, except in 2009 in Portugal, where this is the case of the Non-Big-4.

## 4. Sample and methodology

### 4.1. Sample selection

The data necessary for the study were obtained from the database of the Consortium of the Duty-free Zone of Vigo (ARDAN). It was decided that the sample would be formed by the same number of firms throughout the four years analysed (2007 to 2010). As at the time of the selection of the sample, firms' 2010 data had not yet been published, we selected the sample with the data from the years available (2007–2009). This criterion subsequently turned out to be a limitation, as when all the data on the firms for the year 2010 was available, we could not examine directly the information on 77 firms forming the sample selected.

The procedure used for selection of the sample was the random stratified sampling method without reposition, where the strata are the sectors of activity to which the firms of our population<sup>3</sup> belong, weighted in proportion to the number of firms in the sector. In our case we set the estimation error at  $\varepsilon=0.025$ , the sample size obtained for each year is  $n=753$  companies.

The total number of reports analysed is 2935. For each of the years 2007–2009 we examined 753 reports and for 2010, a total of 676. Therefore, as we have just mentioned, for the latter year we could not physically review the reports of 77 companies, but we were able to verify that 18 of these firms ceased to meet the criteria established in the Spanish regulations for doing a compulsory audit,<sup>4</sup> 21 of the firms were involved in bankruptcy proceedings



(Congress House, 2011) and we were unable to obtain information on the remaining 38 companies.

## **4.2. Methodology**

Our study focuses on analysing the impact of the current financial crisis through the content of audit reports, and especially for those reports with going concern situations. For this, we first describe and classify the different opinions contained in audit reports, making a distinction between those reports that contain a favourable opinion (unqualified opinion) and those that contain a qualified opinion, a disclaimer or an adverse opinion. Opinions with references to going concern problems are analysed separately, as Xu et al. (2011, p. 24) did in their study.

Secondly, taking into account the opinion contained in the report we analyse its relationship with three factors: (i) the audit firm issuing the report; (ii) the existence of a change of auditor; and (iii) the sector of activity to which the firm belongs. The aim is to detect any relation between the opinion in the reports and these factors, placing special emphasis on those reports that present going concern situations.

### **Audit firms**

The relation between the opinion contained in the audit report and the audit firm emitting it has been the subject of study by various authors. There is a belief that the opinion in the audit report may vary according to the type of auditor issuing it, be they part of a large multinational firm, a national company or an individual auditor. It follows that there is a broad range of international empirical literature that has attempted to confirm the veracity of this belief. Based on a sample of companies in Malta, Farrugia and Baldacchino (2005) have carried out a study to analyse the type of opinions contained in unqualified audit reports and their recurrence over the period of time analysed. They discovered significant links between the types of qualifications and variables specific to the audit firms, such as the size of the same, and concluded that the type of qualification contained is related to auditor size. In particular, most of the qualifications issued by Big 4 audit firms are related to disagreements with management qualifications, while small auditors (individual auditors and national companies) emitted mostly limitations on scope qualifications. Through a sample of Greek companies listed on the Athens Stock Exchange, Caramanis and Spathis (2006) carried out a study attempting to determine the extent to which the combination of financial and non-financial variables (such as audit fees and auditor type) can be used to predict the likelihood of the audit report containing a qualified or unqualified opinion. They concluded that neither audit fees nor auditor type ('Big 4' versus 'Non-Big 4') affect the likelihood of an auditor issuing qualified opinions.

Worthy of mention in the United States is the study carried out by Gosman (1973), the first empirical study on audit reports. While it specifically referred to the research on the corporate characteristics of those companies that obtained qualified opinions, it provided empirical proof that those companies audited by the multinational PriceWaterhouse had a higher probability of receiving an opinion qualified due to a lack of consistency, in comparison with those audited by Coopers & Lybrand, where the probability was lower. Warren (Warren, 1975, 1980) carried out a study to ascertain whether auditing standards were applied consistently by different audit firms, studying some of the characteristics of the companies that received qualified opinions to this aim.

Abdel (1985) analysed the characteristics of companies in the United Kingdom whose audit reports contained qualifications, including the audit firm checking the annual accounts. Keasey, Watson, and Wyncarczyk (1988) empirically contrasted whether or not receiving one of the so-called 'small company audit qualifications' could be related to the auditor type.

In Spain, Gómez-Aguilar and Ruiz-Barbadillo (1999) examined the quality of the financial statements in a sample comprised of listed Spanish companies. The study was based on the type of opinion contained in the report and analysed the factors that could be related to the auditor's opinion in some way, whether they derived from the company under audit or the audit firm. Basing their work on a sample of listed Spanish companies, Sánchez-Segura and Sierra (2001) studied the likelihood of receiving a qualified opinion and the relation between said likelihood and certain corporate characteristics that could explain this. Ruiz-Barbadillo, Gómez-Aguilar, and Guiral (2002) carried out an empirical study attempting to analyse the quality of the accounting information in a sample of companies listed on the Madrid Stock Exchange, based on the type of audit opinion received. Among the various analyses carried out in this study, they considered the attitude (conservative or liberal) of the auditing body when issuing unclear audit reports. Caso et al. (2003) examined the annual account audit reports of a sample of companies with the aim of determining the potential effect of certain factors on the same, and confirmed the existence of variables that could affect a company's likelihood of receiving a specific type of opinion, as well as the possibility that said variables could be related to the auditor in some way.

The audit firms have been classified into seven: Deloitte, PriceWaterhouseCoopers, KPMG and Ernst & Young (called the Big 4 in the literature), other multinationals (BDO, Horwath, Moore Stephens, etc.), national audit firms, and individual auditors (denominated Non-Big-4). This classification is based on the fact that the firms making up our sample are not listed on the stock exchange, hence the classification is consistent with the structure of the Spanish audit market, where there are clear differences in the market share of international and national firms (Duréndez & Sánchez, 2008; García-Benau, Ruiz-Barbadillo, & Vico, 1998).

The classification of audit firms in the existing literature is varied; authors such as Xu et al. (2011, 2013) or López-Corrales (1997) use a classification similar to the one used in this paper. Ruiz-Blanco and López-Corrales (Ruiz-Blanco & López-Corrales, 2003) or Mareque et al. (2015) classify auditors into: multinational companies, national companies and individual auditors. Other authors classify audit firms into Big N and Others (Fargher & Jiang, 2008; Krishnan & Krishnan, 1996; Ruiz-Barbadillo et al., 2002).

Many studies include the auditor size variable to indicate whether the report is issued by the firms of larger size (generally the international ones), or by another auditor (usually smaller). The literature reviewed by Carson et al. (2012, 80–81) permits us to conclude that the results are rather varied. Mutchler, Hopwood, and McKeown (1997) include a dummy variable that indicates whether the auditor was a Big 6 or Non-Big-6 audit firm. They find no significant difference in going-concern reporting rates between Big 6 and Non-Big-6 auditors. Boone, Khurana, and Raman (2010) find weak evidence that the Big 4 have a higher propensity to issue going-concern opinions compared with the smaller non-Big-4 auditors. Other studies find that Big 4 clients are significantly less likely to receive going-concern opinions (DeFond, Francis, & Hu, 2011; DeFond & Lennox, 2011; Numan & Willekens, 2012; Reichelt & Wang, 2010). Francis and Yu (2009) argue that within the Big 4 firms, it is the larger audit offices that supply higher quality audits due to their greater in-house expertise.

Using a sample of 6568 US audits by 285 unique Big 4 offices, they find that larger offices are more likely to issue going concern opinions. More recently, Kaplan and Williams (2012, 322) conducted a study whose aim is to provide longitudinal evidence on the changing relationship between audit firm size and auditor going concern reporting. They examine the 22 years between 1989 and 2010, which they classify into four eras (1989–1994, 1995–2001, 2002–2005, and 2006–2010) and the study focuses on three classes of audit firms (Big N, national and regional). They show that over time, for their financially stressed public clients, regional audit firms are increasingly more likely to issue going concern reports, and Big N audit firms are increasingly less likely to issue going concern reports. They also show that in more recent eras, regional audit firms have been more likely than Big N and national audit firms to issue a going concern report to their financially stressed public clients.

### ***Auditor switching***

There is considerable literature on the possible risk of a company changing auditors when issued with a qualified opinion. De Angelo (1981) stated that the causal relationship between qualified opinions and auditor switching can follow two paths. The first refers to the fact that the issue of a qualified audit report can lead to auditor switching. In this regard, we note a group of studies (Beattie & Fearnley, 1995; Bedingfield & Loeb, 1974; Chow & Rice, 1982; Citron & Taffler, 1992; Craswell, 1988; Sánchez-Segura, 2003) that confirm the existence of a statistically positive relation between receiving a report with a qualified opinion and auditor switching. In Spain, García-Benau, Ruiz-Barbadillo, and Vico (2000) state that the type of opinion issued in the audit report has a significant effect, while not excessively decisive in auditor switching. On the other hand, other studies have not found a statistically positive relation between reports with qualified opinions and auditor switching (Burton & Roberts, 1967; Gómez-Aguilar & Ruiz-Barbadillo, 2000; Haskins & Williams, 1990; Schwartz & Menon, 1985; Williams, 1988). The second path broaches the possibility that auditor switching may lead to the issue of an audit report with a qualified opinion (Dye, 1991; Krishnan, 1994; Magee & Tseng, 1990; Teoh, 1992).

Regarding those reports with going concern situations, it has been noted that auditors are more likely to be dismissed a year after the issue of a report on a going concern basis. This discovery has been documented in studies on auditor switching in the United Kingdom (Craswell, 1988; Lennox, 2000), Australia (Carey, Geiger, & O'Connell, 2008), China (Chan, Lin, & Mo, 2006), Belgium (Vanstraelen, 2003) and the US (Carcello & Neal, 2003; Chow & Rice, 1982; Geiger, Raghunandan, & Rama, 1998; Smith, 1986). This offers strong empirical support to the idea that auditor dismissal poses a potential economic threat when the auditor is considering a modified report on a going concern basis. In other words, auditors are aware that they are far more likely to lose their clients and the associated income if they issue a modified auditor's report on a going concern basis.

We have observed whether or not between 2007 and 2010 the firm changed auditor, codifying the variable in two categories, 0 = no change, 1 = change of auditor. When the auditor issues an unfavourable opinion there is a risk that the client firm will decide to change auditor. Some studies examine the relationship between the opinion in the report and the client firm's decision to sack the auditor. The majority of studies at international level found that auditors are more likely to be dismissed a year after issuing a report with an opinion modified by going-concern concerns (Carcello & Neal, 2003; Carey et al., 2008; Chow & Rice, 1982; Craswell, 1988; Geiger et al., 1998; Lennox, 2000; Smith, 1986; Vanstraelen, 2003).

### **Industry sectors**

The sectors of industry to which the firms of our sample belong have been grouped into four categories: construction, agriculture, industry and services. Reichelt and Wang (2010) find that an auditor who is both a national and a city-specific industry specialist is more likely to issue going-concern opinions. However, Minutti-Meza (2011) notes no significant differences in audit reporting between the clients that hire industry specialists and the clients that hire non-specialists when they are matched on industry, size and performance.

Finally, for the period 2009–2010, we have analysed on the one hand the firms whose reports include mentions of going concern situations in 2009, and in 2010 do or do not enter bankruptcy proceedings. On the other hand, we have also analysed those firms whose audit reports do not include references to going concern situations in 2009, and in 2010 do or do not enter bankruptcy proceedings. There is a considerable amount of research that examines: (i) firms entering bankruptcy without a prior going concern qualified opinion, and (ii) firms with an opinion qualified by going concern uncertainty that do not subsequently fail (Carson et al., 2011).

In reference to case (i), in general, the research into the proportion of firms entering bankruptcy without a prior going concern opinion has consistently found that since the adoption of SAS No. 59, approximately half of the companies going bankrupt in the US had not received a prior opinion modified for going-concern uncertainty (Carcello, Hermanson, & Huss, 1995, 1997 and Raghunandan & Rama, 1995). Geiger and Raghunandan (2001) argue that the Private Securities Litigation Reform Act (PSLRA) of 1995 made it less likely that auditors would issue going-concern modified opinions. They find that the proportion of bankrupt companies receiving a prior going concern modified opinion was 59% in the pre-PSLRA period, and drops to 45% post-PSLRA. Other authors study the effect of the business failure of Enron, which led to the passing of the Sarbanes-Oxley Act. They investigate the proportion of firms in bankruptcy with prior going-concern qualified opinions in the pre-Enron and post-Enron periods. In general, the proportion of firms entering bankruptcy with prior going-concern qualified opinions in the post-Enron period increases to approximately 70% (Geiger & Raghunandan, 2001; Geiger, Raghunandan, & Rama, 2005; Feldmann & Read, 2010). Xu et al. (2013) study the proportion of Australian firms that fail without first being alerted to the existence of going-concern situations during the period 2008–2009 (global financial crisis) compared with the period 2005–2007 (pre-global financial crisis). Auditors give more warnings of going concern situations during the financial crisis.

In reference to case (ii), previous studies have consistently found that 80–90% of companies receiving an opinion modified for going concern uncertainty in the US do not fail in the subsequent year (Garsombke & Choi, 1992; Geiger et al., 1998; Mutchler & Williams, 1990; Pryor & Terza, 2002).

In other countries, the evidence is similar to the US. In the UK, the proportion of firms that do not fail in the year subsequent to a going concern opinion is approximately 76–80% (Citron & Taffler, 1992; Lennox, 1999). In Australia, Carey et al. (2008) find that the proportion of firms with going concern opinions that do not subsequently fail is 88% based on first-time going concern recipients from 1994–1997. Xu et al. (2011) report similar rates for periods up to 2008 (global financial crisis). Knechel and Vanstraelen (2007) find that the proportion of firms with going concern opinions that do not subsequently fail is 87% for a sample of stressed private companies in Belgium during the period 1992–1996.

## 5. Descriptive results

According to data from the Bank of Spain (Ortega & Peñalosa, 2012) our country entered recession in the second quarter of 2008 and remained in that situation until early 2010, when a slight recovery began. This fizzled out in the second half of 2011, due to the intensification of the sovereign debt crisis and its generalisation to an ever greater number of countries. Based on these dates, for the interpretation and analysis of the data set out below we have considered 2007 as the point of reference for the comparative analysis, as in this year the crisis was not yet considered to affect Spain.

### 5.1. Audit report trend: 2007–2010

Table 1 summarises the trend of the types of opinion issued for the period 2007–2010. In the two years following the start of the crisis (2008–2009) the total number of audit reports with a favourable opinion fell slightly, from 71.18% in 2008 to 69.99% in 2009. On the other hand, in 2010, the reports with a favourable opinion increased to 74.85%, returning to percentages similar to 2007. A possible explanation of this increase in reports with unqualified opinion in 2010 is the change in the Spanish regulations affecting the issue of the opinion in the report. Section 2 of this paper explained that until 1 January 2011, the Spanish regulations required that when the auditors identified significant uncertainties these should be included in the reports in reservation paragraphs, thus modifying the opinion and leading to a qualified opinion. From this date onwards, following adaptation of our legislation to international standards, significant uncertainties are included in emphasis paragraphs, which do not affect the opinion in the report.

Furthermore, in Table 1, we can see the substantial increase of emphasis paragraphs during 2008, in both reports with a favourable opinion and those with qualifications. Reports with a favourable opinion with an emphasis paragraph rise from 9.03% in 2007 to 67.07% in 2008. The reports with a qualified opinion with an emphasis paragraph rise from 3.85% to 20.45% in 2008. Both situations are a result of the coming into force in that year of a new General Accounting Plan, which included the recommendation by the Spanish Accountancy and Audit Institute (ICAC), to include in the report an emphasis paragraph explaining the situation (ICAC, 2008).

Finally, we observe that, for the four years, the opinion contained in the majority of the reports that include mentions of going concern situations is a qualified opinion. And the number of reports with opinion refused and unfavourable is not significant so much in the crisis period (2008–2010) as in the year before the start of the crisis (2007).

Table 2 attempts to summarise the number of reports that mention going concern situations and the percentage of the total sample analysed, irrespective of whether the references to going concern situations appear in emphasis paragraphs or in qualification paragraphs. In the two years following the start of the crisis (2008–2009) the proportion of reports mentioning going concern situations increases from 2.52% in 2007 to 6.77% in 2008 and 8.50% in 2009. On the other hand, in 2010 there is a slight fall, to 7.25% from 2009. The explanation for this fall is that there are a total number of 77 firms for which we did not have the report, although as already noted, our research registered that 18 failed to reach the limits established in the Spanish regulations for carrying out the compulsory audit, 21

**Table 1.** Frequency of audit reports by type of report 2007–2010.

	Total		2007		2008		2009		2010	
	No.	(%)	No.	(%)	No.	(%)	No.	(%)	No.	(%)
<i>Unqualified</i>	1369	(46.64%)	492	(65.34%)	28	(3.72%)	448	(59.50%)	401	(59.32%)
Unqualified with an emphasis of matter for Going Concern	32	(1.09%)	4	(0.53%)	3	(0.40%)	6	(0.80%)	19	(2.81%)
Unqualified with an emphasis of matter or with other questions (others)	732	(24.94%)	68	(9.03%)	505	(67.07%)	73	(9.69%)	86	(12.72%)
<i>Total unqualified</i>	2133	(72.67%)	564	(74.90%)	536	(71.18%)	527	(69.99%)	506	(74.85%)
<i>Qualified</i>	107	(3.65%)	14	(1.86%)	41	(5.44%)	43	(5.71%)	9	(1.33%)
Qualified for going concern	394	(13.42%)	143	(18.99%)	13	(1.73%)	132	(17.53%)	106	(15.68%)
Qualified with an emphasis of matter for Going Concern	28	(0.95%)	1	(0.13%)	5	(0.66%)	8	(1.06%)	14	(2.07%)
Qualified with an emphasis of matter or with other questions (others)	248	(8.45%)	29	(3.85%)	154	(20.45%)	35	(4.65%)	30	(4.44%)
Disclaimer for going concern	15	(0.51%)	0	(0.00%)	2	(0.27%)	7	(0.93%)	6	(0.89%)
Disclaimer or adverse (others)	9	(0.31%)	2	(0.27%)	2	(0.27%)	1	(0.13%)	4	(0.59%)
Disclaimer or adverse (others) with an emphasis of matter for going concern	1	(0.03%)	0	(0.00%)	0	(0.00%)	0	(0.00%)	1	(0.15%)
<i>Total qualified</i>	802	(27.33%)	189	(25.10%)	217	(28.82%)	226	(30.01%)	170	(25.15%)
<i>Total number of audit reports</i>	2935	(100%)	753	(100%)	753	(100%)	753	(100%)	676	(100%)

Source: Author's calculations.



**Table 2.** Proportion of reports with reference to going concern 2007–2010.

	Total		2007		2008		2009		2010	
	No.	(%)	No.	(%)	No.	(%)	No.	(%)	No.	(%)
Going Concern Reports	183 [122/15] †	(6.24%)	19 [14/0]	(2.52%)	51 [43/2]	(6.77%)	64 [50/7]	(8.50%)	49 [15/6]	(7.25%)
Total number of audit reports	2935	(100%)	753	(100%)	753	(100%)	753	(100%)	676	(100%)

†The first number in square brackets is the number of reports with a paragraph on significant uncertainty with respect to a going concern issue included in a qualified opinion, and the second number in square brackets is the number of reports with a paragraph on very significant uncertainty with respect to a going concern issue included in a disclaimer opinion.

Source: Author's calculations.

were involved in bankruptcy proceedings, and we have been unable to obtain information on the remaining 38.

With the aim of confirming whether the proportion of reports on a going concern basis prevail over the four years of the study, and given that four related samples are being used, we chose Cochran's Q test. We verified hypothesis  $H_0^P$ , where the proportion of reports on a going concern basis is equal over the four years. If the proportion of reports on a going concern basis is  $p_t$  the null hypothesis of the contrast would be:

$$H0P:p_{2007} = p_{2008} = p_{2009} = p_{2010}$$

Under the null hypothesis, the Q statistic of the contrast follows an approximately  $\chi^2$  distribution with three degrees of freedom, which would allow us to reach the critical level associated with the contrast. The value of the statistic corresponding to Cochran's Q test gives a  $q$ -value statistic of  $q^*=48.843$  with an associated critical level of  $p=0.000$ . Given that this critical level is lower than the chosen significance level of 0.05, we can conclude that the proportion of reports on a going concern basis does not prevail over the period in question, as was expected.

Table 3 summarises the principal questions causing inclusion in the report of going concern situations (whether in emphasis paragraphs or qualification paragraphs). We have observed that a total of 46 of the 183 reports that mention going concern situations (25.14%) explicitly state that the main circumstance leading the firm to have going concern problems has been the current financial crisis. The auditors explain that the financial crisis is causing decreased demand and sales, loss of important customers, serious limitations of financing or problems in the valuation of the company's assets (stocks and fixed assets) leading firms to have to reflect in their financial statements important losses due to deterioration.

### **5.2. Audit reports issued by different audit firms**

Table 4 shows the opinion contained in the audit report, taking into account the audit firm that issued it. Although in 2007 there are no significant differences in the average percentage of unqualified reports issued by the Big 4 (73.18%) in comparison with the Non-Big-4 (74.74%), in the remaining years the highest average percentage corresponds to the Non-Big-4. This difference is of around 10 percentage points; consequently, the reports with an unfavourable opinion are issued in a greater percentage by the Big 4.

If we analyse the repercussion in the audit report of going concern opinions in terms of whether it is issued by a Big 4 firm or a Non-Big-4, there are no significant differences in the percentage of reports issued before the start of the crisis (2007) and during the crisis (2008–2010).

The multinational PriceWaterhouseCoopers is, of all the firms classified, the one that issues most going concern qualifications between 2007 and 2009, from 7.14% to 12.50% of the total number of reports issued by this firm. In 2010, it is the multinational firm Deloitte that issues the highest proportion of such reports, 13.21% of its total.

### **5.3. Auditor switching in going concern reports**

Table 5 summarises the existence, or otherwise, of change of auditor in reports that include references to continuity situations, independently of whether this circumstance is reflected

**Table 3.** Issues undermining going concern assumption.

	Total		2007		2008		2009		2010	
	No.	(%)	No.	(%)	No.	(%)	No.	(%)	No.	(%)
Current financial crisis	46	(25.14%)	5	(26.32%)	16	(31.37%)	15	(23.44%)	10	(20.41%)
Negative working capital	24	(13.11%)	4	(21.05%)	4	(7.84%)	12	(18.75%)	4	(8.16%)
Recurring losses	13	(7.10%)	2	(10.53%)	3	(5.88%)	2	(3.13%)	6	(12.24%)
Society could be in the process of dissolution	28	(15.30%)	2	(10.53%)	5	(9.80%)	10	(15.63%)	11	(22.45%)
Scope limitations of the auditor's work	2	(1.09%)	0	(0.00%)	1	(1.96%)	1	(1.56%)	0	(0.00%)
Doubtful receivables and difficult recuperation	14	(7.65%)	1	(5.26%)	4	(7.84%)	4	(6.25%)	5	(10.20%)
Contingent liabilities of a fiscal nature	3	(1.64%)	0	(0.00%)	1	(1.96%)	0	(0.00%)	2	(4.08%)
Commercial and financial transactions with group companies	14	(7.65%)	1	(5.26%)	4	(7.84%)	4	(6.25%)	5	(10.20%)
Tax assets for tax losses from prior years	4	(2.19%)	0	(0.00%)	1	(1.96%)	2	(3.13%)	1	(2.04%)
Bankruptcy proceeding	8	(4.37%)	0	(0.00%)	2	(3.92%)	6	(9.38%)	0	(0.00%)
Others	27	(14.75%)	4	(21.05%)	10	(19.61%)	8	(12.50%)	5	(10.20%)
Total number of audit reports with going concern	183	100%	19	100%	51	100%	64	100%	49	100%

Source: Author's calculations.



**Table 5.** Auditor switching in going concern reports.

	Total		2007		2008		2009		2010	
	No.	(%)	No.	(%)	No.	(%)	No.	(%)	No.	(%)
Going Concern report-same auditor	165	(90.16%)	18	(94.74%)	45	(88.24%)	57	(89.06%)	45	(91.84%)
Going Concern report-new auditor	18	(9.84%)	1	(5.26%)	6	(11.76%)	7	(10.94%)	4	(8.16%)
Total number of audit reports with going concern	183	(100%)	19	(100%)	51	(100%)	64	(100%)	49	(100%)

Source: Author's calculations.

**Table 6.** Types of audit reports by industry.

Industry	2007						2008									
	Total		Unqualified		Qualified		Going concern		Total		Unqualified		Qualified		Going concern	
	No.	(%)	No.	(%)	No.	(%)	No.	(%)	No.	(%)	No.	(%)	No.	(%)	No.	(%)
Construction	99	69 (69.70%)	28	(28.3%)	2	(2.02%)	99	60 (60.61%)	24	(24.24%)	15	(15.15%)				
Agriculture	15	12 (80.00%)	2	(13.3%)	1	(6.67%)	15	10 (66.67%)	3	(20.00%)	2	(13.33%)				
Industrial	290	218 (75.17%)	62	(21.38%)	10	(3.45%)	290	210 (72.41%)	57	(19.66%)	23	(7.93%)				
Services	349	261 (74.79%)	82	(23.50%)	6	(1.72%)	349	253 (72.49%)	85	(24.36%)	11	(3.15%)				
Total number of audit reports	753	560 (74.37%)	174	(23.11%)	19	(2.52%)	753	533 (70.78%)	169	(22.44%)	51	(6.77%)				
			2009						2010							
Industry	Total	Unqualified		Qualified		Going concern		Total	Unqualified		Qualified		Going concern			
	No.	No.	(%)	No.	(%)	No.	(%)	No.	No.	(%)	No.	(%)	No.	(%)		
Construction	99	57	(57.58%)	22	(22.22%)	20	(20.20%)	82	47	(57.32%)	17	(20.73%)	18	(21.95%)		
Agriculture	15	9	(60.00%)	4	(26.67%)	2	(13.33%)	11	9	(81.82%)	2	(18.18%)	0	(0.00%)		
Industrial	290	200	(68.97%)	62	(21.38%)	28	(9.66%)	262	188	(71.76%)	56	(21.37%)	18	(6.87%)		
Services	349	255	(73.07%)	80	(22.92%)	14	(4.01%)	321	243	(75.70%)	65	(20.25%)	13	(4.05%)		
Total number of audit reports	753	521	(69.19%)	168	(22.31%)	64	(8.50%)	676	487	(72.04%)	140	(20.71%)	49	(7.25%)		

Source: Author's calculations.



**Table 7.** Differences of behaviour according to going concern.

	Codification	No.		<sup>2</sup> Pearson ( <i>p</i> value)
		Non Going concern	Going concern	
Crisis	2007 (pre-crisis)	734	19	23.870 (0.000)
	2008–2010 (crisis)	2018	164	
Auditor switching	No change	2592	165	4.873 (0.027)
	Change	160	18	
Audit firm	Non-Big 4	2071	137	0.014 (0.906)
	Big 4	681	46	
Industry sector	Construction	324	55	67.499 (0.000)
	Agriculture	51	5	
	Industrial	1053	79	
	Services	1324	44	

Crisis: Dichotomous variable coded 1 for companies that have been audited in the crisis period (2008–2010), and 0 in the period before the crisis (2007).

Auditor switching: Dichotomous variable coded 1 if there is a change of auditor, and 0 otherwise.

Audit firm: Dichotomous variable coded 1 if the auditor belongs to one of the Big 4, and 0 for the rest of the audit firms.

Industry sector: Categorical variable coded as 0 if the company belongs to the construction sector, 1 if belongs to agriculture, 2 if it belongs to the industrial sector and 3 if you belong to the service sector.

Source: Author's calculations.

in emphasis paragraphs or reservation paragraphs. In general, the changes of auditor in the reports with going concern qualifications are observed to be minimum. During the first two years of the crisis there is an increase compared with the preceding year (2007), of 11.76% in 2008 and of 10.94% in 2009, reducing to 8.16% in 2010.

#### **5.4. Audit reports issued for different industry sectors**

From observing Table 6 we deduce that although before the crisis (2007) the construction sector was one of those containing fewest references to going concern situations, in the remaining years it presents the highest percentages, 15.15% in 2008, 20.20% in 2009 and 21.95% in 2010. These data tend to confirm that the construction sector is one of those most affected by the current financial crisis in Spain.

#### **5.5. Univariate analysis of differences**

We carried out a behaviour difference test, dividing the sample in two; one part including the companies with going concern opinions and the other with the companies that have not received this type of opinion during the period under study. In order to verify the existence of significant differences in the behaviour of both samples, we used Pearson's chi square test as a test statistic, with crisis, audit firm and auditor switching as dichotomous variables, and sector as the categorical variable.

As Table 7 shows, the variables with significant statistical differences are crisis, auditor switching and sector, with a critical contrast level ( $p=0.000$ ; 0.027 and 0.000, respectively) under the significance level of 0.05, and rejecting the null hypothesis of the independence of each of these variables from the going concern opinion. The audit firm variable indicating whether the companies had been audited by a Big-4 audit firm or by others shows a  $p$ -value of 0.906, higher than the significance level of 0.05, and thus we accept the null hypothesis of independence between this variable and the going concern opinion.

**Table 8.** Summary of year 2010 outcomes.

	2010											
	Total		No bankruptcy proceeding		Bankruptcy proceeding		No audited		No information			
	No.	(%)	No.	(%)	No.	(%)	No.	(%)	No.	(%)		
Audit reports with going concern in 2009	64	(8.50%)	43	(67.19%)	8	(12.50%)	5	(7.81%)	8	(12.50%)		
Audit reports without going concern in 2009	689	(91.50%)	633	(91.87%)	13	(1.89%)	13	(1.89%)	30	(4.35%)		
Total reports	753	(100.00%)	676	(89.77%)	21	(2.79%)	18	(2.39%)	38	(5.05%)		

Source: Author's calculations.

We can therefore conclude that all of the four variables analysed show statistically significant differences in relation to whether they had received a going concern opinion or not, with the exception of the variable indicating the audit firm issuing the report.

### **5.6. Analysis of companies in bankruptcy proceedings in 2010**

In the section describing the sample we point out as a limitation of our study that in 2010 we did not have available the audit reports of 77 firms, 21 of which were found to be filing for bankruptcy proceedings. Hence, we proceeded to study whether the auditor had included references to going concern situations in the report of the previous year.

In Table 8 we observe that in 2009 there are 64 firms whose audit reports include references to going concern situations. Of these 64 firms, in 2010 a total of eight firms (12.50%) filed for bankruptcy, a total of five firms (7.81%) did not present an audit report because they did not meet the requirements established in the Law on Auditing of Accounts, and no information was available on eight other firms (12.50%). Of the firms that in the previous year (2009) did not make reference in their audit reports to a going concern situation, only 1.89% filed for bankruptcy in 2010.

Of the 21 firms that filed for bankruptcy in 2010, the audit reports for the previous year of 13 of them did not contain any mention of going concern situations. The audit report of the remaining eight firms did mention going concern problems.

To conclude, it seems of interest to highlight that a total of 18 firms ceased to be audited in 2010 because they did not meet the legal limits established in the Spanish regulations.

## **6. Critical aspects of paragraphs on the principle of going concern**

From the analysis of 183 audit reports of annual accounts during the period 2007–2010 that contain references to going concern concerns in any of their paragraphs, we have observed that on occasions they contain deficiencies in their wording. These deficiencies in the wording of the going concern paragraphs may lead to difficulties of understanding the reports for the different users of the accounting information.

The main deficiencies observed in the wording of the going concern paragraphs are the following.

- From the wording of the paragraph it cannot be concluded that the entity audited will have difficulties for continuing in the years to come. It gives the impression that the auditor does not want to manifest directly the problems of continuity suffered by the entity audited. In other words, the wording of these paragraphs lacks one of the basic characteristics that an auditor must fulfil when writing a report – clarity.
- The Auditing Standard on Going Concern in Spain requires the auditor to mention in the report the factors causing the doubt as to the audited firm's going concern situation, and also to mention the factors, if any, that mitigate this doubt. The mitigating factors are those that tend to reduce or eliminate the doubt as to the entity's capacity to continue as a going concern. We have observed that on occasions no causing factors are cited; on the other hand, mitigating factors are referred to. For example, with regard to mitigating factors, the auditor usually makes reference to future operations, to the

adoption of additional measures, to the possibility of recovery of the sector, etc. On occasions, the auditor does not specify clearly what these mitigating factors are, but merely mentions them. In addition, these circumstances are recorded in the report repeatedly over several years.

- Some reports declare going concern situations because the firm is undergoing bankruptcy proceedings, but it is not clear whether the proceedings have been filed by the audited company itself (voluntary bankruptcy) or by its creditors (involuntary bankruptcy). Once again the lack of clarity in the wording and setting out of the reasons for the going concern problems can lead to confusion on the part of the various users of the reports.
- Some reports, to indicate going concern situations, draw attention to the existence of significant negative working capital in several years, but without making explicit reference to the assumption of going concern in the audit report or in the management report. The lack of information in the management report on going concern situations is another of the deficiencies detected, observing that, in general, the auditor includes no qualification in the audit report for this lack of information.
- Finally, it is notable that it is the so-called Big 4 that writes the circumstances relating to going concern situations most clearly. On the other hand, the individual auditors write out these circumstances with greater deficiencies.

## 7. Conclusions

This paper examines the impact of the current financial crisis on the audit reports on annual accounts issued by auditors. We have observed that this crisis afflicting Spanish firms has not escaped the attention of the audit professionals.

Our study reveals that as the crisis in Spain worsens, the proportion of reports that include going concern opinions increases compared with 2007, a year in which the financial crisis had not manifested itself in Spain. With the aim of confirming whether the proportion of reports on a going concern basis prevail over the four years of the study, we chose Cochran's Q test, concluding that the proportion of reports on a going concern basis do not prevail over the period in question.

Auditors, when mentioning the going concern problems in the report, opted in the first three years (2007–2009) to include them in a qualifications paragraph, and in 2010 in an emphasis paragraph. This change in the manner of including going concern situations in the report is a result of the recent adaptation of the Spanish legislation to international standards, in order to favour the comparability of audit reports to the international economic and financial environment.

Furthermore, from reading and analysing the paragraphs on going concern uncertainties we observe on occasions that they do not make clear that such a circumstance exists. We have detected paragraphs that are difficult to read and interpret, or the same paragraph for several years. We observe the lack of quantification of the factors causing the going concern uncertainty (negative working capital is mentioned, but not quantified). In other cases, the reports reveal a lack of information on the problem causing the going concern uncertainty, both in qualified or emphasis paragraphs and in the management report on the annual accounts. We share the opinion of Gonzalo-Angulo (1995, 623) affirming that audit reports

must change from containing codified information, difficult for non-experts to understand, and become more divulgative, more explanatory, stating the problems detected before evaluating their quantitative effect on the principal accounting reports, and from being written in an obscure and concise style to describing narratively and clearly the responsibilities for information and the points where the auditor finds the greatest obstacles with regard to the future. This cry is becoming more and more difficult to ignore by the profession and the authorities that regulate it.

Most sectors of the Spanish economy are suffering a serious crisis, one of the most affected being real estate and construction (García-Delgado & Myro, 2011). This affirmation has been verified in our analysis, since construction is the sector that includes the greatest number of references in its reports to going concern problems during the years of the crisis (2008–2010).

If we analyse the effect on the audit report of the mentions of going concern situations in terms of the audit firm issuing it, i.e. Big-4 or Non-Big-4, there are no significant differences in the percentage of reports issued before the start of the crisis (2007) and during the crisis (2008–2010). The multinational PriceWaterhouseCoopers issued most going concern opinions between 2007 and 2009, Deloitte in 2010.

In order to verify whether there are significant differences in the behaviour of companies with going concern opinion and who have not received this type of opinion to the variables analysed – crisis, audit firm, auditor switching and industry sector – we carried out a statistical test of differences and concluded that all of the four variables analysed show statistically significant differences in relation to whether they had received a going concern opinion or not, with the exception of the variable indicating the audit firm issuing the report.

One of the consequences of the financial crisis is that firms have more and more financial problems, which are reflected in the data offered by their financial statements (lower turnover, reduction of the number of employees, decreased results, etc.). This leads to firms ceasing to meet the limits stipulated in the regulations for submitting their annual accounts to audit, i.e. volume of turnover, value of assets and average number of workers. We have observed that, in 2010, 18 firms of the 753 forming the sample ceased to submit their annual accounts to audit as they suffered a decrease in these parameters.

Finally, it is notable that in the case of more than half of the firms that filed for bankruptcy in 2010, their audit report for the preceding year did not contain any mention of going concern situations. Issuing reports without mentioning going concern situations on firms that subsequently fail is considered in the literature to be an audit error (known in the literature as a Type II misclassification) and has led the work of the auditor to be questioned (Altman, 1982; Altman & McGough, 1974; Chen & Church, 1992; Hopwood, McKeown, & Mutchler, 1989; McKeown, Mutchler, & Hopwood, 1991; Menon & Schwartz, 1987).

We are aware that auditors are not fortune-tellers and as the regulations themselves indicate, the opinion that they issue is to corroborate the reliability of the annual accounts, and does not constitute a guarantee of the future viability of the entity, but the auditor must also be liable for the audit opinion that he/she issues, at least for the future relatively near to the issue of his/her audit report.

## Notes

1. According to Recommendation 2003/361/CE, of 6 May 2003, the category of micro-firms, small and medium enterprises consists of firms that employ fewer than 250 people and whose annual turnover does not exceed €50 million or whose annual general balance sheet does not exceed €43 million.
2. Section 3 'Technical Audit Standards for reports' of the Spanish Technical Audit Standards is modified by a Resolution of 21 December 2010, of the Institute of Accounting and Auditing (ICAC), with the aim of adapting the minimum content of the audit report to the international auditing standards issued by the IFAC (International Federation of Accountants). This modification of the Spanish standards was done in order to favour comparability in the international economic and financial environment.
3. The starting population in the year 2007 is 27,386 firms.
4. Spanish regulations establish that companies must be audited by reason of size. Thus, they establish that the annual accounts, and where applicable the management report, must be reviewed by an auditor of accounts, companies that can present an abbreviated balance being exempted from this obligation. The companies may draw up abbreviated balance sheet and statement of changes in net assets when on the closing date of each of two consecutive years they meet at least two of the following three conditions: (i) the total value of the asset items does not exceed €2,850,000; (ii) the year's net turnover does not exceed €5,700,000; (iii) the average number of workers employed during the year is not greater than 50.

## Disclosure statement

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