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# Audit Report and Going Concern Assumption in the Face of Corporate Scandals in Nigeria

Dr. A.O. Enofe, Dr. C. Mgbame, Sunday Otuya* & Christopher Ovie
Department of Accounting, University of Benin, Benin City.
Email of corresponding author: otuyasun@yahoo.com

**Abstract**
The study examined the issue of audit reporting and going concern in the face of corporate scandals in Nigeria. We adopted the survey research design. An instrument containing 20 items was designed using the 5-point Likert scales ranging from strongly agree (5) to strongly disagree (1). A total of 60 samples were drawn from the target population using the simple random sampling technique. Out of the 60 questionnaires administered, 44 were returned upon which the analysis was based. Data analysis was carried out with the aid of SPSS (Statistical Package for Social Sciences). The Chi-square statistical technique was used to test the hypotheses at 5% alpha level. It was found that there are differences in going concern reporting among independent auditors. We also found out using the data analyzed that there is a significant relationship between going concern reporting and corporate failures. The study recommended based on these findings, that all involved in the preparation and audit of financial statement must pay careful attention to going concern assumptions.
**Keywords:** Audit Report, Going concern assumption, corporate failure

## 1.0 Background to the Study

The going concern assumption is a fundamental principle in the preparation of financial statements. Under the going concern assumption, an entity is ordinarily viewed as continuing in business for the foreseeable future with neither the intention nor the necessity of liquidation, ceasing trading or seeking protection from creditors pursuant to laws or regulations (Nogler, 2008). Accordingly, unless the going concern assumption is inappropriate in the circumstances of the entity, assets and liabilities are recorded on the basis that the entity will be able to realize its assets, discharge its liabilities, and obtain refinancing (if necessary) in the normal course of business.

The decision as to what type of audit report to issue to a client requires professional judgment by the auditor. Nowhere is this more clearly illustrated than in the auditor's decision to issue an opinion modified for going-concern uncertainty to a financially distressed client. Issuing an opinion modified for going-concern uncertainty can be costly for the client as it can restrict access to funding sources, adversely impact the company's stock market valuation, and can even hasten the company's ultimate failure. Therefore, not surprisingly, clients typically do not like to receive any report other than a standard, unmodified audit report.

Issuing an opinion modified for going-concern uncertainty can also be costly for the auditor because a disgruntled client that receives what is perceived to be an unwarranted going-concern modification is much more likely to switch to a different auditor resulting in a loss of revenues from both auditing and non-audit services. (Adeyemi & Uadiale, 2011). On the other hand, shareholders, lenders, creditors, regulators and other users of the financial statements rely on the auditor to give timely warning of impending corporate failure. The assessment of an entity's ability to continue as a going concern is the responsibility of the entity's management; and the appropriateness of management's use of the going concern assumption is a matter for the auditor to consider on every audit engagement. Some financial reporting frameworks contain an explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern, and standards regarding matters to be considered and disclosures to be made in connection with going concern.(ICAN,2006).

In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the balance sheet date. The degree of consideration depends on the facts in each case. When an entity has a history of profitable operations and ready access to financial resources, a conclusion that the going concern basis of accounting is appropriate may be reached without detailed analysis. In other cases, management may need to consider a wide range of factors relating to current and expected profitability, debt repayment schedules and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate.

The current global financial crisis has resulted in a significant increase in company failures and has generated renewed interest in auditor reporting on financially troubled clients. In the last few years, many corporate reporting scandals in Nigeria have shaken investors' confidence and brought the question of auditor's report as it relates to the going concern assumption to the furore. Some of the recent corporate scandals in Nigeria with going concern issues include: Afribank Nigeria Plc, Oceanic Bank International plc, and Cadbury Nigeria Plc. (Adeyemi and Udiale, 2011)

According to Akpotu and Israel (2013), the magnitude of these events has focused public attention on the accounting profession as never before, and has increased the pressure to ensure that universally high standards of accounting practice are in place everywhere.

At Cadbury Nigeria Plc, the financial statements were falsified until December 12, 2006, when the Managing director and the financial director were suspended for cooking and window dressing the books of account of the company. These financial books padding scandal and corruption lasted for three years where the company's financial position was overstated to the tune of between N13 and N15 billion and if this is to be corrected, it will lead to an operating loss of N1 to N2 billion Naira. This can be seen as the Nigerian version of Enron corporation scandal in the United States. In the same view, at Afribank Nigeria Plc, the former Managing Director accused the Board of Directors of colluding with its external auditors to window dress the books of accounts for some time. At former Oceanic Bank, corporate reporting failure and arrest of the Chief executive as are result of fraudulent financial reporting has led to the takeover of the bank by Ecobank (Akpotu & Israel,2013 ;Akenbo & Ibanichuka, 2012; Nwaogu, 2006; Ossisioma & Enahoro, 2006)

Indeed, under the auditing standards published by the Institute of Chartered Accountants of Nigeria (ICAN) the fact that a company goes under within a year of receiving a clean auditors opinion does not in itself, indicate inadequate performance by the auditor. Further, that the absence of a going-concern clause "should not be viewed as providing assurance as to an entity's ability to continue as a going concern (ICAN, 2006; Olabiyi, 2006). These two points over the years appear to have been lost on many stakeholders. The standards place responsibility on auditors to identify trends—recurring operating losses or negative operating cash flow, for instance, that may raise substantial doubts about a company's ability to survive until its next fiscal year. And when doubts surface, auditors are supposed to consider management's plans to mitigate the doubts.

**1.1 Statement of the Problem**

Recently the number of distressed companies filing for reorganization and bankruptcy has significantly increased. Auditors and all stakeholders in businesses are aware of the very severe worldwide economic crisis. In other words, there is concern about auditors' awareness of matters relating to the consideration of applying the going-concern assumption when preparing financial statements. Furthermore, businesses are faced with the challenge of evaluating the effect of the credit crisis and economic downturn on the entity's ability to continue as a going concern. Questions have been raised as to whether such effects on the entity ought to be described or otherwise reflected in the financial statements.

The statement of problem is that the audit reporting among auditing firms has not been able to adequately highlight the going concern of corporate organizations in Nigeria. This study seeks to examine how audit reporting and going concern assumption has affected corporate collapse in Nigeria.

**1.2 Research Questions**

1. To what extent does going concern reporting among auditing firms differ?
2. To what extent has collapse of companies' highlighted problems with reporting on going concern?

**1.3 Objectives of the Study**

In line with the research questions, the objectives of this study are to:

(i) Determine if there are differences in reporting of going concern concept in analysis of a company annual report.

(ii) Ascertain to what extent the collapse of companies has highlighted problems with reporting going concern

**1.4 Research Hypothesis**

The following hypotheses will be tested in the course of this research study:

Ho1: There exists no significant difference in going concern reporting among auditing firms.

Ho2: There is no relationship between going concern reporting and corporate scandals.

**2.0 Literature Review**

Studies on the going concern principle are numerous and widespread (Adela, 2010; Enyi, Ifurueze & Enyi, 2012; Fellingham & Newman, 1989; Best, Buckby & Tan, 2001; Adeyemi & Uadiale, 2011; Nogler, 2008). The specialized literature offers multiple general well-documented descriptive or much practical approaches of this accounting-audit phenomenon. Research on going concern reveals studies with different topics or hypotheses – bankruptcy and auditor going concern, modification judgments and accounting regulation, the role of the going-concern opinion in valuing companies' stocks, empirical analysis, models and financial ratios to identify the probability of going concern. (Carson, Fargher, Geiger, Lennox, Raghunandan & Willenkens, 2012)

Companies are required to prepare financial statements on a going-concern basis unless a plan of liquidation has been approved by the entity's owners or the plan to liquidate is being imposed by other forces and it is very unlikely that the entity will remain a going-concern in the future (Akpotu & Israel, 2013). From the legal requirements point of view, accounting approaches of the going concern principle dates back to 1975, when

International Accounting Standard *IAS 1* Disclosure of Accounting Policies (the present Presentation of Financial Statements) described the going concern principle. In compliance with the paragraph 25 of IAS 1, an entity preparing IFRS financial statements is presumed to be a going concern. If management has significant concerns about the entity's ability to continue as a going concern, the uncertainties must be disclosed. If management concludes that the entity is not a going concern, the financial statements should not be prepared on a going concern basis, in which case IAS 1 requires a series of disclosures (IAS 1, par. 25), (Carson, Fargher, Geiger, Lennox, Raghunandan & Willenkens, 2012).

Adela (2010) asserts that for the periods beginning on or after December 15, 2009, the going concern is based on statement of the International Standard on Auditing ISA 570 Going concern. According to this regulation, the auditor's responsibility is to obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation of the financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern. Arguing further, Adeyemi & Uadiale(2011), maintain that auditors need to obtain sufficient appropriate audit evidence regarding the appropriateness of management's use of the going concern assumption in the preparation of the financial statements before concluding, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

In reality, the unqualified opinion is wrongly seen as a certification that the firm or enterprise is solvent, liquid and has the capacity to adapt to the dynamics of the environment. Any subsequent failure of business resulting from management misjudgment, fraudulent practice, economic instability, inconsistency in micro and macroeconomic policies etc are viewed as failures of auditors (Adeniji, 2004).

**2.1 The audit procedures in going concern review**

ISA 570 requires auditors to review the management's going concern assumption. The management's going concern assumption period coincide with the period for auditor's judgment. Best, Buckby & Tan (2001) opine that auditors shall cover the same period as that used by management to make its assessment as required by the applicable financial reporting framework, or by law or regulation if it specifies a longer period. If management's assessment of the entity's ability to continue as a going concern covers less than twelve months from the date of the financial statements, the auditor shall request management to extend its assessment period to at least twelve months from that date.

For the auditor professional judgment, the going concern principle is not a simply test of a balance sheet. According to Mgbame, Erhaghe & Osazuwa (2012), the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists through performing additional audit procedures, including consideration of mitigating factors. Nogler (2008) list the procedures to include:

a) Where management has not yet performed an assessment of the entity's ability to continue as a going concern, requesting management to make its assessment.

b) Evaluating management's plans for future actions in relation to its going concern assessment, whether the outcome of these plans is likely to improve the situation and whether managements' plans are feasible in the circumstances.

c) Where the entity has prepared a cash flow forecast, and analysis of the forecast is a significant factor in considering the future outcome of events or conditions in the evaluation of management's plans for future action: Evaluating the reliability of the underlying data generated to prepare the forecast; and Determining whether there is adequate support for the assumptions underlying the forecast.

d) Considering whether any additional facts or information have become available since the date on which management made its assessment.

e) Requesting written representations from management and, where appropriate, those charged with governance, regarding their plans for future action and the feasibility of these plans.

**2.2 Going Concern Assumptions.**

Auditors cannot be considered a prophet – they do not predict future events or developments. But the auditors shall consider whether there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern (Olabiyi, 2006). After auditors identify events or conditions which may affect the going concern assumption, they have to analyze the impact on the company. This listing is not all-inclusive nor does the existence of one or more of the items always signify that a material uncertainty exists. The significance of such events or conditions often can be mitigated by other factors (Akpotu & Israel, 2013). For example, the effect of an entity being unable to make its normal debt repayments may be counter-balanced by management's plans to maintain adequate cash flows by alternative means, such as by disposing of assets, rescheduling loan repayments, or obtaining additional capital.

**3.0 Methodology**

The study adopted the survey research design and data were drawn from primary sources. The primary data were elicited from respondents drawn from auditing firms in main cities of Rivers, Delta and Edo states using the simple random and convenience sampling technique from ICAN register of members in the areas. A sample size of 100 respondents was used and a total of 100 questionnaires were distributed. However, we were only able to retrieve 44 of the completed questionnaires due to time constraint. We analyzed the data collected using the SPSS version 15.0 and used the chi-square to test the hypotheses formulated at 5% level of significance. With a view to harvesting information from respondents, a self-developed questionnaire designed using the 5-point Likert scales ranging from strongly agree (5) to strongly disagree (1) was deployed. The instrument has 20 items.

**4.0 Results**

Table 1: Descriptive Statistics of Primary Data

| SN | VARIABLE HIGHLIGHTED IN QUESTIONNAIRE | N | SA | A | UN | D | SD | MIS | STD |
|---|---|---|---|---|---|---|---|---|---|
| | | | 5 | 4 | 3 | 2 | 1 | | |
| 1 | Accounting concept of Going Concern is important in analysis of a comapny | 44 | 7<br>15.9% | 29<br>65.9% | 6<br>13.6% | 1<br>2.3% | 1<br>2.3% | 3.91 | .77 |
| 2 | Corporate failures have highlighted problems with reporting going concern | 44 | 3<br>6.8% | 25<br>56.8% | 8<br>18.2% | 5<br>11.4% | 3<br>6.8% | 3.45 | 1.02 |
| 3 | Responsibility to report on whether an entity will continue as a going concern lies with management | 44 | 10<br>22.7% | 11<br>25.0% | 3<br>6.8% | 14<br>31.8% | 6<br>13.8% | 3.11 | 1.43 |
| 4 | Responsibility to report on whether an entity will continue as a going concern lies with independent auditors | 44 | 6<br>13.6% | 31<br>70.5% | 4<br>9.1% | 2<br>4.5% | 1<br>2.3% | 3.89 | .78 |
| 5 | Auditors report should identify the basis and reasons for concluding that the entity may not be able to continue as a going concern | 44 | 8<br>18.2% | 19<br>43.2% | 11<br>25% | 3<br>6.8% | 3<br>6.8% | 3.59 | 1.09 |
| *6* | The time period to assess whether an entity will continue as a going concern should be more than twelve months from date of financial statement | 44 | 10<br>23.3% | 17<br>39.5% | 10<br>23.3% | 6<br>14.% | 1<br>2.3% | 3.63 | 1.05 |
| 7 | Going concern disclosures should be reported in other non-accounting report | 44 | 8<br>18.2% | 30<br>68.2% | 5<br>11.4% | 1<br>2.3% | 0 | 4.02 | .63 |
| 8 | The size of audit firm impacts on the going concern reporting | 44 | 13<br>29.5% | 23<br>52.3% | 8<br>18.2% | 0 | 0 | 4.11 | .69 |
| 9 | There are differences in going concern reporting among audit firms | 44 | 6<br>13.6% | 20<br>45.5% | 12<br>27.3% | 3<br>6.8% | 3<br>6.8% | 3.52 | 1.05 |
| 10 | Modified audit reports relating to going concern issues are indication of audit quality | 44 | 14<br>36.4% | 20<br>46.6% | 0 | 3<br>6.8% | 3<br>6.8% | 4.34 | .53 |
| 11 | Auditors independence reflects on going concern reporting | 44 | 16<br>36.4% | 25<br>56% | 1<br>2.3% | 1<br>2.3% | 1<br>2.3% | 4.23 | .80 |
| 12 | Going concern reporting helps in preventing corporate scandal | 44 | 13<br>30.2% | 24<br>55.8% | 2<br>4.6% | 4<br>9.3% | 1<br>2.3% | 4.07 | .86 |
| 13 | Going concern reporting enhances quality of financial statement relevance and reliability | 44 | 7<br>16.3% | 20<br>46.5% | 11<br>23.3% | 4<br>9.3% | 2<br>4.6% | 3.60 | 1.03 |
| 14 | Going concern assumption is a concept that has not been taken serious by most audit firms | 44 | 16<br>37.2% | 19<br>44,2% | 2<br>4.6% | 5<br>11.6% | 1<br>2.3% | 4.02 | 1.06 |
| 15 | Stakeholders do not bother about the going concern reporting of corporate | 44 | 6<br>13.6% | 22<br>50.% | 12<br>27.3% | 4<br>9.1% | 0 | 3.68 | .83 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | entities | | | | | | | | |
| 16 | Contemporary audit reports do not provide sufficient information about going concern of companies | 44 | 8 19% | 22 50% | 6 14.3% | 2 4.6% | 2 4.6% | 3.74 | 1.01 |
| 17 | Disclosures of going concern concept is critical to investors decision making | 44 | 6 14.3% | 22 50% | 12 27.3% | 2 4.6% | 2 4.6% | 3.68 | .83 |
| 18 | Awareness of going concern by stakeholders is low in Nigeria | 44 | 4 9.1% | 22 50% | 10 22% | 6 13.6% | 2 4.6% | 3.45 | 1.00 |
| 19 | Going concern reporting can serve as a framework to facilitate corporate stability | 44 | 12 27.3% | 18 41.9% | 7 16.3% | 4 9.1% | 2 4.6% | 3.79 | 1.10 |
| 20 | Investment is safer in a company where going concern is reported by the auditors | 44 | 10 22% | 22 50% | 6 14.3% | 2 4.6% | 2 4.6% | 3.71 | 1.04 |

Source:Sunny/Ovie Fieldwork, 2013.

KEY: N= Respondents: SA= strongly agree: A= Agree: UN=undecided/ indifference: D= disagree: SD= strongly disagree: MIS= mean Item Score: STD= standard deviation/ variation ratio:

**4.1 Findings**

All respondents to this survey are professional chartered accountants who are practicing in an audit firm. 31 of the respondents are male representing 70.4% while 13 of the respondents are female chartered accountants. Also, 23 of the respondents representing 52.2% have been in practice for over ten years while 21 respondents have only been in practice for less than ten years.

**4.2 Test of hypotheses**

The hypotheses stated earlier in this study are hereby tested using the chi-square

Ho1: There exists no significant difference in going concern reporting among auditing firms.

This was achieved by subjecting item (9) in the questionnaire as a variable for chi-square test. ($X^2$ =17.82, $p<.05$). Using alpha level of 0.05, we reject the null hypothesis and conclude that there exist differences in going concern reporting by independent auditors. This is consistent with the responses from the questionnaire of which over 62% of respondents in item (6) agree that size of audit firms impacts on the going concern reporting. This means that bigger audit firms with greater independence report going concern problems than the non-big audit firms.

Ho2: There is no relationship between going concern reporting and corporate scandals.

In testing the second hypothesis, which states that there is no relationship between going concern reporting and corporate scandals. We used item (1) on the spreadsheet to test this hypothesis. It was found that there is a significant relationship between going concern reporting and corporate scandals and failures. ($X^2$ = 40.37, $p<.05$). There is evidence therefore to reject the null hypothesis and accept the alternative hypothesis that there is a significant relationship between going concern reporting and corporate failures. To further reaffirm this evidence, item responses from item (19) shows that over 30 of the respondents agree that going concern reporting can promote corporate stability in the economy.

**5.0 Conclusion and Recommendation**

This study investigated audit reports and going concern assumptions as it relates to the corporate scandals in Nigeria. From the findings of this study, it could be concluded that going concern reporting is highly significant in an audit report. This is to enhance confidence as well as promote corporate stability.

Further, we found out that most corporate scandal and collapse in Nigeria in the past few years have all had a link with going concern related problems. We also discovered that the entity's interaction with the auditor is very important to facilitate the identification of possible events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. The significance of these events or conditions is varied from entity to entity, but may be mitigated by other factors.

Management elaborates a financial report that gives a true and fair view of the entity's financial position, cash-flows and results. Auditors review the financial report and the incorporated financial statements in order to formulate an opinion and to consider whether all the management's disclosures present a true and fair view of the entity.

In light of the above findings, we recommend that all involved in the preparation and audit of financial statement must pay careful attention to whether the going concern assumptions continue to be appropriate and what disclosures may be required.

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