

**An Experimental Investigation of Alternative Going Concern Reporting Formats:
A Canadian Experience**

Asokan Anandarajan, Ph.D.
School of Management
New Jersey Institute of Technology,
University Heights
Newark, NJ 07102
U.S.A.

Chantal Viger, Ph.D.
Accounting Department
Université du Québec à Montréal
Branch Centre Ville
Montreal (Quebec)
Canada H3C 3P8

Anthony P. Curatola, Ph.D
Joseph F. Ford Professor of Accounting
Bennet S. Lebow College of Business
Department of Accounting
Drexel University
Philadelphia, PA 19104
U.S.A

November 7, 2000
Revision APC

Corresponding author :

Asokan Anandarajan, Ph.D.
School of Management
New Jersey Institute of Technology,
University Heights
Newark, NJ 07102
U.S.A.

Telephone No: 973-596-8568
Fax No: 732-583-1942

e-mail: KrishniA@worldnet.att.net

ABSTRACT

Canadian reporting standards do not require the auditor's report to be qualified (modified) if the going concern contingency is described in the notes that accompany the financial statements. In response to criticism that this approach is passive and the signal mute (Bortiz 1991), the Canadian Institute of Chartered Accountants issued an exposure draft where the going concern uncertainty is highlighted separately as a "stand alone" note. The intent of the note was to provide a stronger warning signal to financial statement users. The standard has been withdrawn (CICA 1999) but discussions with members of the standard setting body indicate that the issue is still of concern and that the project is currently being considered by the recently established International Auditing Practices Committee (IAPC). This study examines the incremental information content of the current Canadian standard relative to the proposed standard and the standards generally in force in developed foreign nations. The results indicate that Canadian bank loan officers, view more negatively and in ranked order the information presented in the foreign format to the proposed Canadian format to the current Canadian format. Although ranked ordered, the results further indicate that once the going concern note is fully disclosed in the notes, it does not matter if the going concern note is integrated with the other notes or shown separately as a stand-alone note. However, when the auditor's report is, in addition, modified with an explanatory paragraph detailing the uncertainty and referencing the appropriate note in the footnotes, (foreign format) the signal appears to be accentuated.

1. INTRODUCTION

In September 1995 and January 1996, the Canadian Institute of Chartered Accountants (CICA) issued two exposure drafts entitled respectively *Auditor's Responsibility to Evaluate the Going Concern Assumption* and *Going Concern*. The proposed standards made certain significant changes to the existing laws with the objective of communicating information more clearly to financial statement users. The main change related to the presentation of information to financial statement users when a company faced going concern uncertainties.¹

In issuing its exposure drafts, the CICA adopted the rationale (CICA, 1996, note 12) that “the going concern disclosure contains information that is relevant to the interpretation of the financial statements, and therefore, the required information belongs in the notes to the financial statements”. Accordingly the going concern uncertainties would be included in the financial statements as a separate note that is labeled “Going Concern.” The CICA further held that a “stand alone” footnote would sufficiently warn financial statement readers about problems that could potentially affect the going concern status of the company. Therefore the auditor would not need to qualify (modify) the report if the assets and liabilities are appropriately classified and reported and the going concern problem properly disclosed in the notes to the financial statements (CICA, 1995). The presumption is that the information will be fully incorporated into the decision process by simply highlighting the situation in a stand-alone footnote.

The CICA, in adopting their position, had taken a difference stance relative to regulatory bodies of other countries where the audit report is modified to reflect the going concern uncertainties. In the

¹ Going concern uncertainties are defined as events that could cast substantial doubt about a firm's ability to continue to survive in the foreseeable future. Foreseeable future in turn is defined as a period of twelve months from the date of completion of the financial statements.

United States, for example, two auditing standards address this issue: Statement of Auditing Standard (SAS) No. 58 entitled *Reports on Audited Financial Statements* and SAS No. 59 entitled *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*. These statements require auditors to modify the auditor's report with a fourth explanatory paragraph in addition to having a separate note to the financial statements. The fourth explanatory paragraph describes the events that cause doubt about the entity's ability to continue as a going concern. The auditor's report is technically referred to as an unqualified modified report. The explanatory paragraph acts as a "red flag" to financial statement users.

In the United Kingdom, the Auditing Practices Board (APB) issued SAS 130 *The Going-Concern Basis in Financial Statements* (APB 1994). Shrikes (1996) notes "the APB understands that users need information on going-concern and that, where there are problems, adequate warnings need to be given and, the more uncertain things are, the more attention needs to be drawn to those warnings". Like the ASB, the APB via SAS 130 adopts a similar position by requiring the auditor not only to actively search for going concern problems but also to modify the report if required. Yet further still in Australia and New Zealand, the auditor's report while unqualified is modified with an "emphasis of matter" paragraph detailing the going concern uncertainty (AU 708). Thus it would appear that the proposed Canadian standard does not go as far as other international standard setting bodies with respect to the going concern issue. The question, therefore, is whether the disclosure format in the financial statements significantly influences the decision maker.

2. MOTIVATION & OBJECTIVE

The purpose of the exposure draft was to adopt a more informative approach to reporting going

concern uncertainties. Although the exposure draft was withdrawn (CICA 1999)² in 1999, the issue has not disappeared. Rather, it will now come under the ambit of the newly appointed International Auditing Practices Committee (IAPC), which is considering harmonizing Canadian standards with that of other developed countries

The objective of this study is to provide evidence on the informational consistency with respect to the going concern contingency when reported in accordance with Canadian and other developed countries. To this end, an experiment is conducted on the signal conveyed by the various disclosure formats as currently provided, proposed in the exposure draft, and currently provided by foreign nations. Canadian bank loan officers for the different forms of reporting assessed a loan decision and the riskiness of the loan.

3. LITERATURE REVIEW

While there have been many studies in this area, it is difficult to draw conclusions from the literature since all the studies have, without exception, examined the information content of the qualification of the auditor's report vis-à-vis no disclosure and/or footnote disclosure. In this study we examine whether

Mr. Peter Martin, Principal of Accounting Standards (CICA) explains as follows the circumstances that led the CICA to withdraw the exposure draft:

"The Accounting Standards Board started its going concern project in implementing recommendations of the Macdonald report that dealt with deficiencies in financial reporting involved in the western bank failures of the 1980s. However, by the mid-1990s, economic conditions were sufficiently strong and other accounting issues sufficiently pressing that the Going Concern project lost priority. The Board was also losing staff resources necessary to sustain all of its projects. In addition, the technical issues proved difficult to address and no consensus appeared to be emerging on specific requirements to include in a standard. At the same time, the auditing project appeared to be heading in a direction that would not be fully consistent with the accounting project. Efforts were undertaken to create a single task force for the accounting and auditing projects, but by that time the accounting project was essentially inactive. The auditing project was faced with the establishment of an International Auditing Practices Committee project on going concern, also. It was agreed that the Canadian auditing project should be done through the IAPC, which effectively cut the ties to the Canadian accounting project."

differences in presentation significantly affects the signal relating to the going concern uncertainty to financial statement users. Consequently, we only draw upon studies pertinent to the development of theory for the research question in this paper.

Much of the research in this area has focused on a model of the consequences of auditor's decision making proposed by Libby (1979a). Most researchers in the U.S. have expressed concern that misperceptions of the auditor's report and financial statements can influence users' reactions, which in turn can adversely influence decision-making. In one of the first studies of its kind, Libby (1979b) examined the impact of the location and method of disclosing uncertainties. The uncertainty related to a defendant in a lawsuit. Libby divided loan officers into three groups; each group received an unqualified opinion, a disclosure only, or a disclosure with a qualified opinion. The results showed that once there was footnote disclosure, adding a qualified opinion did not affect risk perception. Pursuant to this theory, it can be argued that once the going concern uncertainty has been disclosed (current standard), the signal should not be significantly accentuated by highlighting the uncertainty in a stand alone paragraph (proposed exposure draft) or by modifying the auditor's report with an explanatory paragraph (U.S standard). Houghton (1983) drew similar conclusions in a similar study with Australian loan officers.

In another study pertaining to Canadian loan officers, Abdel-Khalik, Graul and Newton (1986) found that, while bankers regarded disclosure of an uncertainty in the notes as relevant information, the addition of a qualified opinion had no significant impact on bankers' decisions beyond what a footnote only would disclose. This finding corroborated the findings of the Libby study. A year later, Gul (1987) found contrary results in a study involving Singapore loan officers. Pringle, Crum, and Swetz (1990)

concluded that the method of reporting going concern did not matter as long as the auditor communicated the message.

In summary theory would suggest that, once the going concern uncertainty is disclosed, the mode and or style of presentation will not significantly influence decision-makers. Hence, the decision to give a loan and the riskiness of that loan should not be statistically affected by the different styles of presenting going concern uncertainties.

4. RESEARCH QUESTION, RESEARCH DESIGN AND HYPOTHESES

4.1 Research Question

The following research question is examined; namely, does the form and locations of a going concern contingency significantly influence loan officers' perceptions of risk and decision-making? The form and location include an integrated note as in the current Canadian standard; stand alone note with referencing as in the proposed exposure draft, and a note combined with an explanatory paragraph as in the U.S and other developed countries.

4.2 Research Design

To provide evidence on the proposed research question, a four-group research design (as shown in Figure 1) is used. Figure 1 highlights the differences among the four groups. The first group (hereafter G1) received financial statements presented according to current Canadian standards; the second group (hereafter G2) received financial statements with the presentation of the going concern based on the proposed exposure draft; and the third group (hereafter G3) received financial statements presented according to current U.S standards. Finally, a control group (hereafter G4) was included in

the study. The case study given to G4 was identical except it contained an unqualified opinion with no going concern note. The purpose of the control group was to ensure that the going concern note rather than extraneous factors drove any results in the financial statements.

INSERT FIGURE 1 HERE

4.3 Hypotheses

Five sets of hypotheses (all stated under their alternate form) were tested in order to address the research question. Initially the stand alone going concern paragraph in the notes to the financial statements is tested to see if it conveys incremental information to loan officers relative to the integrated contingency note. This set of hypotheses (referred to as H1b, H2b, H3b, H4b and H5b) compares the Canadian's proposed standard (G2) to the current Canadian standard (G1). Next, the modified auditor's report with an explanatory paragraph detailing the uncertainty is tested to see if it accentuates the signal relative to the disclosure of the going concern in a stand alone note only. This set of hypotheses (referred to as H1b, H2b, H3b, H4b and H5b) compares the informational influence of the standard of countries such as the US (G3) to the Canadians' proposed standard (G2).

Typical lending decisions by banks are generally a two-step process. The decision-maker must first decide whether to accept or reject the actual loan application and then, if accepted, to select an interest rate premium (i.e., the incremental rate above the prime rate). Libby (1979a) noted that the user's reaction depends on the perception of the message received. Consequently, if the proposed stand alone note sends a clearer signal to loan officers relative to a discussion of the going concern problem only in the contingencies note, we would expect bank loan officers to react more strongly to this form of reporting. Consequently, the first hypothesis to be tested is as follows:

H1a: The decision to decline a loan will be greater when the going concern contingency is disclosed according to the proposed Canadian exposure draft relative to the current Canadian reporting standard.

Hence, H1a suggests the following impact:

$$C_{(\text{Proposed})} > C_{(\text{Current})}$$

where,

$C_{(\text{Proposed})}$ = number of decisions to decline a loan based on the proposed Canadian standard (i.e., stand alone note)

$C_{(\text{Current})}$ = number of decisions to decline a loan based on existing standard (i.e., integrated note)

Similarly, if the U.S. method of modifying the auditor's report with an explanatory paragraph in addition to a separate going concern note sends a stronger signal to loan officers relative to the proposed standard, then we would expect a stronger reaction by bank loan officers to this form of reporting.

Thus, the hypothesis is stated as follows:

H1b: The decision to decline a loan will be greater when the going concern contingency is disclosed according to current U.S. standards relative to the proposed Canadian exposure draft.

Hence, H1b suggests the following impact:

$$C_{(\text{U.S standard})} > C_{(\text{Proposed})}$$

where,

$C_{(\text{U.S standard})}$ = number of decisions to decline a loan based on a modified report with a fourth explanatory paragraph detailing the uncertainty and referencing to the going concern note in the end notes of the report

$C_{(\text{Proposed})}$ = number of decisions to decline a loan based on a stand alone note

The pricing decision on borrowings under a line of credit is also dependent on the message received by users. If the accompany information increases the severity of the situation, then the cost to borrow the funds is likely to increase. To test this issue, the following two hypotheses are stated:

H2a: The pricing decision will be greater when the going concern contingency is disclosed according to the proposed Canadian exposure draft relative to disclosure according to the current Canadian reporting standard.

H2a suggests the following impact:

$$\mu_{\text{Interest (Proposed)}} > \mu_{\text{Interest (Current)}}$$

where,

$\mu_{\text{Interest (Proposed)}}$ = mean interest rate premium based on a stand alone note

$\mu_{\text{Interest (Current)}}$ = mean interest rate premium based on an integrated note

H2b: The pricing decision will be greater when the going concern contingency is disclosed according to current U.S. standards relative to the proposed Canadian exposure draft.

Hence H2b suggests the following impact:

$$\mu_{\text{Interest (U.S standard)}} > \mu_{\text{Interest (Proposed)}}$$

where,

$\mu_{\text{Interest (U.S standard)}}$ = mean interest rate premium based on a modified report with a fourth explanatory paragraph detailing the uncertainty and referencing the going concern note in the end notes

$\mu_{\text{Interest (Proposed)}}$ = mean interest rate premium based on a stand alone note

Gul (1987) noted that an increased level of disclosure about an uncertainty, including a going concern uncertainty might be expected to increase the variance of computed cash flows, which in turn may influence perceptions of the ability of the company to service debt. Thus, the increased level of disclosure may result in a perception of greater risk. Based on this position, the following set of hypotheses to be tested (H3a and H3b) are stated:

H3a : Bank loan officers' perception of the ability of the company to service debt will be lower under when the going concern contingency is disclosed according to the proposed Canadian exposure draft relative to the current Canadian reporting standards.

As a result, H3a suggests the following relationship:

$$\mu_{\text{Ability to service debt (Proposed)}} < \mu_{\text{Ability to service debt (Current)}}$$

where,

$\mu_{\text{Ability to service debt (Proposed)}}$ = the mean perception of the ability to service debt based on a stand-alone note

$\mu_{\text{Ability to service debt (Current)}}$ = the mean perception of the ability to service debt based on an integrated note

H3b : Bank loan officers' perception of the ability of the company to service debt will be lower when the going concern contingency is disclosed according to U.S standards relative to the proposed Canadian exposure draft.

With respect to H3b, the following relationship is suggested:

$$\mu_{\text{Ability to service debt (U.S standard)}} < \mu_{\text{Ability to service debt (Proposed)}}$$

where,

$\mu_{\text{Ability to service debt (U.S standard)}}$ = the mean perception of the ability to service debt based on a modified auditor's report, which references a going concern note in the end notes

$\mu_{\text{Ability to service debt (Proposed)}}$ = the mean perception of the ability to service debt based on a stand alone note

LaSalle and Anandarajan (1997) found that the level of disclosure of the going concern uncertainty impacts users' (loan officers in their study) perceptions of the likelihood (or lack thereof) of a company improving its profitability. Based on those results, the following set of hypotheses is stated:

H4a : Bank loan officers' perception that the company can improve its profitability will be lower when the going concern contingency is disclosed according to the proposed Canadian exposure draft relative to the current Canadian reporting standard.

Hence, H4a would suggest the following impact:

$$\mu_{\text{Likelihood of improving profitability (Proposed)}} < \mu_{\text{Likelihood of improving profitability (Current)}}$$

where,

μ Likelihood of improving profitability (Proposed) = the mean perception of the likelihood of improving profitability based on a stand alone note

μ Likelihood of improving profitability (Current) = the mean perception of the likelihood of improving profitability based on an integrated note

H4b : Bank loan officers' perception that the company can improve its profitability will be lower when the going concern contingency is disclosed according to the current U.S. standards relative to the proposed Canadian exposure draft.

Hence, H4b suggests the following impact:

$$\mu \text{ Likelihood of improving profitability (U.S standard)} < \mu \text{ Likelihood of improving profitability (Proposed)}$$

where,

μ Likelihood of improving profitability (U.S standard) = mean perception of the likelihood of improving profitability when the report is modified with an explanatory paragraph detailing the uncertainty and referencing the going contingency note in the end notes.

μ Likelihood of improving profitability (Proposed) = the mean perception of the likelihood of improving profitability based on a stand alone note

Libby (1979) and Gul (1987) found that uncertainty disclosure would cause, among others, an increase in the desire for additional information with which to estimate the effects of the uncertainty. Based on their findings, the final set of hypotheses to be tested are given:

H5a: Bank loan officers' need for additional information will be greater when the going concern contingency is disclosed according to the proposed Canadian exposure draft relative to the current Canadian reporting standard.

H5a suggests the following relationship:

$$\mu_{\text{Need of additional information (Proposed)}} > \mu_{\text{Need of additional information (Current)}}$$

where,

$\mu_{\text{Need of additional information (Proposed)}}$ = the need for additional information based on a stand alone note

$\mu_{\text{Need of additional information (Current)}}$ = the need for additional information based on an integrated note

H5b: Bank loan officers' need for additional information will be greater when the going concern contingency is disclosed according to the current U.S.A standards relative to the proposed Canadian reporting standard.

H5b suggests the following relationship:

$$\mu_{\text{Need of additional information (U.S standard)}} > \mu_{\text{Need of additional information (Proposed)}}$$

where,

$\mu_{\text{Need of additional information (U.S standard)}}$ = the need for additional information based on a modification of the auditor's report with an explanatory paragraph referencing the stand alone going concern note in the end notes

$\mu_{\text{Need of additional information (Proposed)}}$ = the need for additional information based on a stand alone note

5.0. RESEARCH METHODOLOGY

5.1 Sample

Financial statement users comprise a wide spectrum that includes financial analysts, bankers, and regulatory bodies. Many different types of users have been used as subjects in prior studies including financial analysts (Bailey 1981; Robertson 1988), student surrogates (Abdel-Khalik et al., 1985; Pringle et al., 1990), and bank loan officers (Libby 1979; Geiger 1989 ; Bamber and Stratton 1997 ; LaSalle and Anandarajan 1997).

Bank loan officers were chosen from the available group of users because they are one of the most important groups of financial statement users. Further, bank loan officers are a relatively homogenous group with similar backgrounds, working for similar organizations, and perform similar tasks to meet similar goals.

A survey instrument was constructed and sent to loan officers. The participants were asked to respond to a questionnaire after studying a set of financial statements and then to state their decision as to whether they would (or would not) grant a loan and their perception of risk. The advantages of this method are the ability (a) to elicit responses from a national sample and thereby increase the external validity and (b) to permit participants' adequate study and response time.

5.2 Survey Instrument

The research instrument consisted of a covering letter, descriptive information about a hypothetical company, auditor's report, balance sheet (3 years), statements of income and retained earnings (3 years), statements of cash flow (3 years), and notes to financial statements. In the appropriate cases, the note highlighting the going concern problem was also included.

The survey instrument consisted of only seven questions and is provided in the appendix. The first two questions in the questionnaire sought background information about the respondents. Questions 3 and 4 sought the participants' reaction to the case material. Specifically, question 3 elicited the

respondent's willingness to grant a line of credit to the hypothetical company in the case study. Question 4 requested the respondents to state what premium (i.e., spread over the bank's base lending rate) they would charge on the line of credit. The remaining questions sought the respondents' perceptions of risk toward the company.

6. RESULTS

Four major Canadian banks agreed to participate in the study. Each bank was willing to provide not only provide a list of their respective institutions' loan officers but also a letter requesting their members to participate and emphasizing the regulation implications of the study. A random sample of three hundred loan officers from the list of officers was contacted to participate in the study. Each respondent was assured of anonymity. Each willing participant was randomly assigned to one of four groups (three experimental groups and one control group). A total of 174 loan officers completed the questionnaire, which resulted in an overall response rate of 58 percent.

[This paragraph bothers me. In particular, the statement about the Chi-square test. Is this correct?] The incremental effects among the groups were tested by means of a Kruskal Wallis Chi-square test and an ANOVA with a between-subjects design. The ANOVA provides an overall test for significant differences among mean scores. In cases where significance was detected, further testing by means of the Scheffe multiple comparison tests was employed to identify the differences among the groups.

Before analyzing the responses to the cases, an examination was conducted to determining if the groups were similar with respect to the personal characteristics of the participants (i.e., level of education and experience). Table 1 shows that the bank loan officers that participated in the study, on average,

have a bachelor's degree and between 10 and 15 years of experience. An analysis of the demographic characteristics did not reveal any statistical differences among the groups.

INSERT TABLE 1

The first set of hypotheses related to the willingness of the loan officers to grant a loan. A Chi-square test was performed to assess whether the bank loan officer's willingness to grant a loan is affected by the difference in presentation of the going concern note. The results, as shown in Panel A of Table 2, indicate that the difference between the four groups is statistically significant (p value = 0.000). In addition, the Cramer's V (0.339) shows the strength of the relation between the type of going concern note presentation and the decision to grant a loan. **[I think that we need to say something about the Cramer V result – Is it good, bad or what?]**

Table 2 further shows that 56.1 percent (or 23 out of 41 responders) were willing to grant a loan for the control group (G4). However, the response rate to grant a loan drops off to 35.0 percent (or 14 out of 40 responders) for G1 and 22.2 percent (or 10 out of 45 responders) for G2 and as low as 14.6 percent (or 7 out of 48 responders) for G3.

[I believe that H1a and H1b are incorrectly analyzed. Because we have different number of observations in each group, the Chi2 test should be done on the percentages of loans granted and not the number of loans granted. This should give us statistical results to support our position. Hence, the following paragraph is incorrect. Likewise, the two hypotheses need to be restated to reflect percentages and not numbers. Remember, I could be wrong.]

Three additional Chi-square tests were then performed (first, on experimental groups G1 and G2 for testing H1a; second, on experimental groups G2 and G3 for testing H1b; and finally, on experimental G1 and G3). The results indicate that the difference between G1 and G2 is not statistically significant (p -

value = 0.191 as shown in Panel B of Table 2). Thus, Hypothesis H1a does not appear to be supported. Similarly, the result of the second Chi-square test indicates that the difference between G2 and G3 is not statistically significant (p-value = 0.341). Thus, Hypothesis H1b is not supported either. However, there was a significant difference between Group 1 and Group 3 (p-value = 0.025). In group 1 (existing Canadian standard), the auditor's report is unqualified and no mention is made of the going concern uncertainty. In Group 3 (existing U.S standard), the auditor's report is modified with a fourth explanatory paragraph detailing the uncertainty and referencing the contingency note in the endnotes. This indicates that modifying the report with a reference to the going concern uncertainty in the notes significantly accentuates the message relative to an auditor's report, which is unqualified with no referencing.

INSERT TABLE 2 HERE

The next set of hypotheses related to the interest rate (referred to as pricing by loan officers) that bank loan officers would charge if a loan had been granted. Based on the second set of hypotheses, the expected relationship among the group means would be as follows:

$$\mu_{\text{Interest (U.S standard)}} > \mu_{\text{Interest (Proposed)}} > \mu_{\text{Interest (Current)}} > \mu_{\text{Interest (Control)}}$$

Each term was defined previously.

[J test goes here;]

The mean pricing charged (i.e., premium over the prime rate) was lowest for the control group (average of 0.90 with a standard deviation of 0.50) and highest for the developed countries standard (average of 1.59 with a standard deviation of 0.45). The ANOVA test (p-value = 0.000) and the Kruskal Wallis Chi-square test (p-value of 0.000), as shown in Panel A of Table 3, indicate that there is a significant difference among the groups. The significant result indicates that the difference in style of

presentation did influence decision-making as surrogated by the premium attached to the prime rate of interest.

To isolate the differences among groups, the Scheffe Multiple Comparison test was performed and its results are given in Panel B of Table 3. As can be seen, the style of presentation under the proposed standard (G2) relative to the current Canadian standard (G1) does not significantly (p-value = 0.389) increase premium interest rate charge. This suggests, as stated before, that, once the going concern uncertainty is disclosed in the notes, disclosure in various forms within the notes does not appear to significantly influence loan officers' decision making. But on the other hand, the Scheffe Multiple Comparison test does show that the U.S style (G3) of presentation relative to the proposed standard of presentation (G2) did significantly (p-value = 0.001) influence the premium rate charged over base lending rate. Thus, the modification of the auditor's report with a description of the uncertainty appears to accentuate the message. Moreover, it suggests that the objective of the Canadian current as well as the proposed standard would not achieve harmony with that of other developed countries as being considered by the IAPC.

INSERT TABLE 3

The third set of hypotheses focused on the perception to service the debt and would be stated as follows:

$$\mu_{\text{Ability to service debt (U.S)}} < \mu_{\text{Ability to service debt (Proposed)}} < \mu_{\text{Ability to service debt (Current)}} < \mu_{\text{Ability to service debt (Control)}}$$

Each of the above terms was defined previously.

As shown in Panel A of Table 4, the mean perception of a company's ability to service debt declined from the control group (mean of 3.93) to the current Canadian form (mean of 3.26), proposed Canadian form (mean of 3.07), and finally developed countries form (mean of 2.37). The Jonckheere-

Terpstra test was performed on the data to determine whether the mean perceptions were ordered statistically. An analysis of the data collected for the four groups resulted in a z value of 11.18 (p value of 0.000), which is shown in Panel A of Table 4. Consequently, the increased level of disclosure about uncertainty decreases the perception by the loan officers for a company's ability to service its outstanding debt. This conclusion is consistent with the premise held by Gul (1987).

INSERT TABLE 4 ABOUT HERE

The next issue is to determine if evidence among the groups exists. Panel A of Table 4 shows a statistical difference among the four groups does exist as evidenced by a p value of 0.000 for both the F-test and the Kruskal Wallis Chi-square test.

Finally, the Scheffe multiple comparison tests were conducted to establish which group differed, which are given in Panel B of Table 4. The comparisons of the control group (G4) with each experimental group are all significant. Furthermore, a significant difference (p value of 0.009 and 0.001 respectively) exists between the developed countries presentation (G3). Thus, the explanatory paragraph in the auditor's report appears to accentuate the signal and H3b is supported. On the other hand, no difference is detected by the Scheffe tests (p value of 0.822) between the two Canadian forms of presentation. As a result, H3a is not supported.

The perception concerning the likelihood of improving profitability is examined by the following set of hypotheses:

$$\mu_{\text{Likelihood of improving profitability (U.S.)}} < \mu_{\text{Likelihood of improving profitability (Proposed)}} < \mu_{\text{Likelihood of improving profitability}}$$

$$(\text{Current}) < \mu_{\text{Likelihood of improving profitability (Control)}}$$

All the above terms were previously defined.

The mean perception of likelihood of a company to improve its profitability declined from the control group (mean of 3.56) to the current Canadian form (mean of 2.87) to the proposed Canadian form (mean of 2.49), and finally to the developed countries format (mean of 2.44). This ordering is the same as that given on the debt servicing. Again, the Jonckheere-Terpstra test was performed on the data to determine whether the mean perceptions were ordered statistically. An analysis of the data collected for the four groups resulted in a z value **[this needs to be completed]**, which is shown in Panel A of Table 5. Consequently, **[this needs to be completed]**

INSERT TABLE 5 ABOUT HERE

The next issue is to determine if evidence among the groups exist. Panel A of Table 5 shows a statistical difference among the four groups does exist as evidenced by a p value of 0.000 for both the F-test and the Kruskal Wallis Chi-square test.

Finally, the Scheffe multiple comparison tests were conducted to detect for difference among the four groups. The tests' results are given in Panel B of Table 4. As shown in the Table, the comparisons of the control group (G4) with each experimental group are all significant (p-value of 0.002 for G1 versus G4; p-value of 0.000 for G2 versus G4; p-value of 0.000 for G3 versus G4). Since the Scheffe test does not provide any strong evidence to support a difference between any other group comparisons, neither H4a nor H4b is supported. Bank loan officers' perception of the likelihood of the company improving profitability is not significantly higher when going concern uncertainties are presented in the form of a clearly labeled stand alone (G2) than when they are integrated in the notes to the financial

statements (G1). The difference between the group receiving the U.S modified report (G3) and the group receiving the current Canadian format of presentation (G1) is marginally significant with a p value 0.089. [Table 4 says 0.093, which is correct?]

The fifth set of hypotheses (H5s) suggests the following impact:

$$\mu_{\text{Need of additional information (U.S standard)}} > \mu_{\text{Need of additional information (Proposed)}} > \mu_{\text{Need of additional information (Current)}} > \mu_{\text{Need of additional information (Control)}}$$

Each of the above terms was previously defined.

The mean perception of the need to search for additional information was contrary to expectations (as shown in Table 6). Specifically, the need for additional information declined from the proposed Canadian form (mean of 4.68) to developed countries format (mean of 4.04) to the control group format (mean of 3.61), and finally to the current Canadian formats (mean of 2.18). One possible explanation for this unexpected result is the level of comfort of each loan officer with the current system and the decline of that level of comfort with respect to the proposed and developed countries format. Panel A shows a significant difference (p value = 0.000 for both the F-test and the Kruskal Wallis Chi-square test) between the four groups.

The Scheffe multiple comparison tests were conducted to detect for difference among the four groups. The tests' results are given in Panel B. As shown in Panel B, all paired comparisons were significantly different. As a result, both H5a and H5b are supported.

INSERT TABLE 6 ABOUT HERE

7. CONCLUSIONS, IMPLICATIONS AND LIMITATIONS

In Canada, under the present standard, the going concern uncertainty is integrated with the contingency note in the financial statements. In addition, while much of the world with the exception of Canada modify the auditor's report in the presence of going concern uncertainties, Canada provides an unmodified (clean) report if the going concern uncertainty is disclosed in the notes to the financial statements. Boritz (1991) has commented that this method is too passive and the signal "mute". Consequently, the CICA proposed changes in an exposure draft in order to enhance communication to financial statement users. In this study, we examine whether the proposed method of communication accentuates the message about the going concern contingency to loan officers. The results of this study are mixed. On one hand, the results indicate that once the going concern note is fully disclosed in the notes, the style of presentation within the notes (stand alone note versus an integrated note) does not significantly influence the reactions and perceptions of risk if the auditor's report is unmodified (unqualified). On the other hand, when the auditor's report is modified with an explanatory paragraph detailing the uncertainty and referencing the going concern note in the footnotes, the signal appears to be accentuated (as supported by H2b, H3b and H5b).

Should the CICA keep the status quo with the current standard? It depends. The results suggest that the proposed, and current standard, are not perceived by Canadian loan officers to communicate the same message as that of other developed countries. Apparently, the modification of the auditor's report and referencing the footnote describing the going concern contingency (as done by most developed countries) conveys a stronger signal relative to the present or proposed standard. These results are consistent with the criticisms leveled by Boritz that the current standard is too mute and passive. Hence, given the priorities of the IACP and of the AcSB of developing Canadian standards that harmonize with international standards (CICA, 2000, p.1), the findings of provide some evidence on this

matter.

The results of this study are subject to limitations. First, the experimental design that was used does not consider all the costs and benefits associated with real bank loan officers' decision making. Second, the information provided to participants was less than the amount of information that is generally available to bank loan officers. Third, the participants in the study represent only one population of financial statement users. The reaction of other users and potential users of financial information will be of interest to the IACP and the AcSB if and when they deliberate the reporting standard of a going concern contingency.

REFERENCES

- Abdel-Khalik, A.R., P.R. Graul and J.D. Newton. 1985. "Eliminating 'Subject to' Audit Qualifications and Bankers' Assessment of Risk." Unpublished Working Paper, University of Florida.
- Abdel-Khalik, A.R., P.R. Graul, and J.D. Newton. 1986. Reporting Uncertainty and Assessment of Risk: Replication and Extension in a Canadian Setting. *Journal of Accounting Research* (24): pp. 372-382.
- _____. 1988a. Statement on Auditing Standards No. 58 "*Reports on Audited Financial Statements.*" New York, NY: AICPA.
- _____. 1988b. Statement on Auditing Standards No. 59 "*The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern.*" New York, NY: AICPA.
- _____. 1995. Amendments to Statement on Auditing Standards No. 58 "*Reports on Audited Financial Statements.*" Statement on Auditing Standards No. 79. New York, NY: AICPA.
- Auditing Practices Board. 1993. Statement on Auditing Standards 130. *The Going Concern Basis in Financial Statements.* London: APB, 1993.
- Australian Auditing Standards Board. 1998. Statement on Auditing Standard 708. Going Concern. Australia, AASB. 1998.
- Anandarajan, A. 1995. "A Comparison of the Disclaimer and Unqualified Modified Reports: User Perception and Auditor Choice." Ph.D. Dissertation, Drexel University (March).
- Bailey, W.T., 1981. The Effects of Audit Reports on Chartered Financial Analysts' Perceptions of the Sources of Financial Statement and Audit Report Messages. *The Accounting Review* October. Pp. 882-896.
- Bamber, E. M. and R.A. Stratton. 1997. The Information Content of the Uncertainty-Modified Audit Report : Evidence from Bank Loan Officers. *Accounting Horizons* Vol. 11. No. 2 (June) pp. 1-11.
- Boritz, J.E., 1991, L'hypothèse de la continuité d'exploitation et ses répercussions sur la comptabilité et la vérification, Rapport de recherche. Toronto: ICCA. 263p.
- _____. 1988. Report of the Commission to Study the Public's Expectations of Audits.

June ; 186 pages.

- _____. 1995. Auditing Standards Board. Proposed Auditing Recommendations “ Auditor’s Responsibility to Evaluate the Going Concern Assumption.” September.
- _____. 1996. Accounting standards Board. Proposed Accounting recommendations “Going Concern.” January.
- _____. 1999. « Department Digest: A Summary of Current CICA Projects and Initiatives », *The Canadian Account*, Fall 1999, p.2.
- _____. 2000. « New Era Begins for the Accounting Standards Board, *The Canadian Account*, Winter, p.1.
- Geiger, M., 1989. Audit Disclosures of Consistency: An Empirical Analysis of SAS No. 58 Unpublished Working Paper, Pennsylvania State University.
- Gul, F. A. 1987. The Effects of Uncertainty Reporting on Lending Officers’ Perception of Risk and Additional Information Required. *ABACUS* vol. 23 No. 2 , pp.172-79.
- Houghton, K.A., 1983. Audit Reports: Their Impact on the Loan Decision Process and Outcome: An Experiment. *Accounting and Business Research* Vol. 66 pp. 15-20.
- Lasalle, R.E., and A. Anandarajan. 1997. Bank Loan Officers’ Reactions to Audit Reports Issued to Entities with Litigation and Going Concern Uncertainties *Accounting Horizons* vol. 11 No. 2 (June), pp. 33-40.
- Libby, R. 1979a Bankers and Auditors’ Perceptions of the Message Communicated by the Audit Report. *Journal of Accounting Research* Vol. 17. pp. 99-122.
- _____. 1979b The Impact of Uncertainty Reporting on the Loan Decision. *Journal of Accounting Research* (supplement), pp. 35-57
- Pringle L.M , R.P Crum and R.J Swetz, 1990. Do SAS No 59 Format Changes Affect the Outcome and the Quality of Investment Decisions *Accounting Horizons* (September), pp.68-76.
- Robertson, J.C., 1988. Analysts’ Reactions to Auditors’ Messages in Qualified Reports. *Accounting Horizons* (June) pp. 82-89.
- Shrives, P. 1996. The new Face of Auditing. *Management Accounting* Vol. 74(5), pp. 26-29.

Figure 1

Experimental Design

Experimental Groups					
Each participant received an information set that presents a set of financial statements including three years balance sheet, income statement, and cash flow statements. Notes to the financial statements are provided for the current year.					
Group 1	Group 2	Group 3	Group 4		
(Current Canadian standards)	(Proposed Canadian exposure draft)	(Current American standards)	(Control Group)		
L	L	L	L		
Mode of communication of the going concern uncertainty	The going concern uncertainty is discussed <u>only</u> in the contingencies note in the financial statements.	The going concern uncertainty is discussed in a <u>stand alone note</u> in the financial statements	The going concern uncertainty is discussed in a <u>stand alone note</u> in the financial statements	<u>No</u> reference made to the going concern uncertainty in the notes in the financial statements.	
	The auditor's report is unqualified.	The auditor's report is unqualified	The auditor's report is both unqualified and modified	The auditor's report is unqualified.	

Table 1
Comparison of Experimental Groups

	Group	Mean	Standard Deviation	Statistic *** (p.value)
Level of Education *	Group 1 (Current Canadian)	3.61	1.50	F=.588 (.577) KW $\chi^2 = 2.277$ (0.517)
	Group 2 (Proposed Canadian)	3.40	1.34	
	Group 3 (Current American)	3.81	0.96	
	Group 4 (Control)	3.68	0.85	
	Overall statistic	3.63	1.19	
Level of Experience **	Group 1 (Current Canadian)	3.05	1.05	F=1.754 (.158) KW $\chi^2 = 5.916$ (0.116)
	Group 2 (Proposed Canadian)	2.64	1.09	
	Group 3 (Current American)	2.77	1.02	
	Group 4 (Control)	2.51	1.29	
	Overall statistic	2.74	1.12	

* Level of education is measured as follows :

1. Some high school
2. High school graduate
3. Some college
4. Bachelor's degree
5. Some graduate work
6. Master's degree
7. Graduate work beyond master's

** Level of experience is measured as follows :

1. Under 5 years
2. 5- Below 10 years
3. 10- Below 15 years
4. 15 years and over

*** Legend

KW χ^2 : Kruskal Wallis Chi-square test

Table 2
Panel A
Cross-tabulation of Audit Report and investment decision

		Experimental Groups				Total
		Group 1 Current Canadian	Group 2 Proposed Canadian	Group 3 Current American	Group 4 Control Group	
Investment Decision	Yes	14 (35%)	10 (22%)	7 (14.6%)	23 (56%)	120
	No	26 (65%)	35 (78%)	41 (85.4%)	18 (44%)	54
	Total	40	45	48	41	174

Panel B
Additional Chi-square test for hypothesis testing

Overall statistic

Chi square (performed on G1, G2, G3 and G4) = 20.029

P value = 0.000

Cramer's V = 0.339

Test for H1a :

Chi square (G1 versus G2) = 1.706

P value = 0.191

Test for H1b :

Chi square (G2 versus G3) = 0.907

P value = 0.341

Additional Chi-square :

Chi square (G1 versus G3) = 5.006

P value = 0.025

Table 3

Panel A
Tests of Differences in Decisions Making

	Group	Mean	Standard Deviation	F-statistic (p.value)
Pricing charged over the bank's base lending rate («Prime rate »)	Group 1 (Current Canadian)	.99	.95	F= 8.579
	Group 2 (Proposed Canadian)	1.27	.89	(.000)
	Group 3 (Current American)	1.59	.45	KW $\eta^2 = 31.781$
	Group 4 (Control)	.90	.50	(0.000)

Panel B

Scheffe Multiple Comparison of pricing charged over the bank's base lending rate

Comparison of groups		Hypothesis	p.value
Group 1 (Current Canadian) v	Group 2 (Proposed Canadian)	H2a	.389
Group 1 (Current Canadian) v	Group 3 (Current American)		.215
Group 1 (Current Canadian) v	Group 4 (Control group)		.164
Group 2 (Proposed Canadian) v	Group 3 (Current American)	H2b	.001*
Group 2 (Proposed Canadian) v	Group 4 (Control group)		.951
Group 3 (Current American) v	Group 4 (Control group)		.000*

* The mean difference is significant at .05 level

Table 4**Panel A****Tests of Differences in Decisions and Perceptions of Bank loan officers**

	Group	Mean	Standard Deviation
Perception of the company's ability to service debt (H _{3s})	Group 1 (Current Canadian)	3.26	1.07
	Group 2 (Proposed Canadian)	3.07	1.18
	Group 3 (Current American)	2.37	.79
	Group 4 (Control)	3.93	.79
		F = 19.338 (0.000)	
		KW η^2 =45.680 (0.000)	
		J = 11.19 (0.00?)	

Panel B**Scheffe Multiple Comparison in Perceptions of bank loan officers**

	Hypothesis	Comparison of Groups		p.value
Perception of the company's ability to service debt	H _{3a}	Group 1 (Current Canadian) v	Group 2 (Proposed Canadian)	0.822
		Group 1 (Current Canadian) v	Group 3 (Current American)	0.001*
		Group 1 (Current Canadian) v	Group 4 (Control group)	0.029*
	H _{3b}	Group 2 (Proposed Canadian) v	Group 3 (Current American)	0.009*
		Group 2 (Proposed Canadian) v	Group 4 (Control group)	0.001*
		Group 3 (Current American) v	Group 4 (Control group)	0.000*

Table 5**Panel A****Tests of Differences in Decisions and Perceptions of Bank loan officers**

	Group	Mean	Standard Deviation
Perception of the company's likelihood to improve its profitability (H _{4s})	Group 1 (Current Canadian)	2.87	1.03
	Group 2 (Proposed Canadian)	2.49	.84
	Group 3 (Current American)	2.44	.62
	Group 4 (Control)	1.34	.69
F = 20.153 (0.000)			
KW η^2 =44.734 (0.000)			
J =			

Panel B**Scheffe Multiple Comparison in Perceptions of bank loan officers**

	Hypothesis	Comparison of Groups		p.value
Perception of the company's likelihood to improve its profitability	H _{4a}	Group 1 (Current Canadian) v	Group 2 (Proposed Canadian).	0.182
		Group 1 (Current Canadian) v	Group 3 (Current American)	0.093*
		Group 1 (Current Canadian) v	Group 4 (Control group)	0.001*
	H _{4b}	Group 2 (Proposed Canadian) v	Group 3 (Current American)	0.992
		Group 2 (Proposed Canadian) v	Group 4 (Control group)	0.002*
		Group 3 (Current American) v	Group 4 (Control group)	0.000*

Table 6**Panel A****Tests of Differences in Decisions and Perceptions of Bank loan officers**

	Group	Mean	Standard Deviation
Perception of need to search for additional information (H _{5s})	Group 1 (Current Canadian)	2.18	1.02
	Group 2 (Proposed Canadian)	4.68	1.01
	Group 3 (Current American)	4.04	.62
	Group 4 (Control)	3.61	.63
F = 13.321 (0.000)			
KW η^2 = 43.797 (0.000)			

Panel B**Scheffe Multiple Comparison in Perceptions of bank loan officers**

	Hypothesis	Comparison of Groups	p.value
Perception of need of search for additional information	H _{5a}	Group 1 (Current Canadian) v Group 2 (Proposed Canadian).	0.000*
		Group 1 (Current Canadian) v Group 3 (Dev. Countries/ US)	0.012*
		Group 1 (Current Canadian) v Group 4 (Control group)	0.007*
information	H _{5b}	Group 2.(Proposed Canadian) v Group 3 (Dev. Countries/US)	0.010*
		Group 2.(Proposed Canadian) v Group 4 (Control group)	0.030*
		Group 3 (Dev. Countries/US) v Group 4 (Control group)	

