

*Frequency and nature of the reporting of going concern by auditors in the financial statements of Australian listed companies*

**Report produced for Australian Accounting Standards Board**

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# ***Frequency and Nature of the Reporting of Going Concern by Auditors in the Financial Statements of Australian Listed Companies***

This report presents descriptive statistics on the reporting of going concern in the audit reports of financial statements of ASX listed companies.

Analysis is presented for Australia and the World (hereafter referred to as RoW) based on the financial statements for the financial year 2021 and across the 2010-2020 period.<sup>1</sup>

The objective is to provide a ‘stocktake’ of the current reporting of going concern by auditors which may provide some useful background information for identifying areas of economic importance for further investigation and the policy deliberations.

## **Key findings:**

- Australia has a very high frequency of Material Uncertainty Related to Going Concern opinions (MUGC) compared to RoW. In 2021, 20% (5%) of audit reports for Australian (RoW) companies had MUGC
- A partial explanation for the high frequency of MUGC opinions in Australia is Australia’s large mining sector however all industry sectors in Australia have a greater frequency of MUGC than RoW.
- There is a significant minority of MUGC firms (approx. 25%) whose financial performance and financial position is not significantly different from many unqualified firms.
- The two auditors with the greatest number of MUGC opinions as a % of the total number MUGC opinions are BDO (24% of all MUGC opinions) and Grant Thornton (11% of all MUGC opinions).
- As at 1<sup>st</sup> August 2022, only 4% of the firms with MUGC opinions issued in 2021 had delisted. Therefore, there is no evidence that MUGC are predicting liquidation for the median firm.

## **1. Frequency of Audit Opinions**

Audit opinions are classified into four groups: Unqualified, Qualified, Material Uncertainty Related to Going Concern (MUGC) and Adverse. Table 1 reports the frequency of each category for both Australia and the RoW for both 2021 and the period from 2010 to 2020. Main observations:

- In 2021, less than 1% of audit opinions for Australian companies were qualified and there were no adverse opinions
- Across the 2010-2020 period, 2.59% (3.04%) of Australian (RoW) companies had a qualified opinion.
- Australia has a very high frequency of MUGC compared to RoW. In 2021, 20% (5%) of audit reports for Australian (RoW) companies had MUGC
- This greater frequency has persisted across time. Across the 2010-2020 period 33% (15%) of Australian (RoW) companies had an audit opinion with an MUGC section
- Figures 1 to 3 graphs the frequency of audit opinions across time.

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<sup>1</sup> We exclude from the sample firms in the financial sector (GICS Sector 40) and REITS (GICS Sector 60). RoW only includes those countries in the Standard and Poors Compustat database with more than 100 listed stocks.

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### **2. Why does Australia have a High Frequency of MUGC audit opinions compared to RoW?**

**3.**

- Table 2 reports the frequency of MUGC opinions by industry sector classification as a % of the total number of MUGC opinions and within each sector as a % of the number of firms in that sector.
- The two sectors with the greatest number of MUGC opinions as a % of total MUGC opinions are the material and mining sector (49% of all MUGC opinions) and Energy (11% of all MUGC opinions). Thus, a partial explanation for the high frequency of MUGC opinions in Australia is Australia's large mining sector
- However, all other Australian sectors have a greater frequency of MUGC opinions *within* the industry sector compared to the RoW. We compute for each sector the number of MUGC as a % of the number of firms in that sector. For example, in the Consumer Discretionary sector 14% of Australian firms have a MUGC compared to only 6% for RoW. Likewise in the Healthcare sector 24% of Australian firms have a MUGC compared to only 6% for RoW.

### **4. What are the characteristics of Australian firms that have an MUGC opinion?**

Table 3 reports descriptive statistics on the financial characteristics of a firms with a MUGC compared to firms that had an unqualified opinion. Main points:

- The median size of a MUGC firm (\$13m) is significantly smaller than the median size of an unqualified firm (\$44m). More specifically, the frequency of MUGCs is spread across the size distribution of Australian companies as follows: 44% are micro firms; 29% are small firms; 19% are medium firms; and 6% are large firms.
- The mains factors associated with the typical MUGC opinions are poor financial performance and cashflow from operations.
  - The median financial performance of MUGC firms as measured by Sales Growth (-19%) and ROA (-21%) is significantly worse than unqualified firms (6% and -6.41%)
- Debt levels are not significantly different between MUGC and Unqualified firms and does not appear to be the primary determinant of MUGC. This is consistent with many of the MUGC firms being mining firms where debt is not a significant source of funding.
- There is a significant minority of MUGC firms (approx. 25%) whose financial performance and financial position is not significantly different from many unqualified firms.

## **5. Which audit firms issue MUGC?**

- Table 4 reports the frequency of MUGC opinions by auditor as a % of the total number of MUGC opinions and within each auditor as a % of the number of firms in the auditor's client portfolio
- The two auditors with the greatest number of MUGC opinions as a % of total MUGC opinions are BDO (24% of all MUGC opinions) and Grant Thornton (11% of all MUGC opinions).
- The two auditors with the greatest number of MUGC opinions as a % of their client portfolio are BDO (34% of their clients have MUGC opinions) and Grant Thornton (34% of their clients have a MUGC opinion).

## **6. Frequency of KAMs with GC**

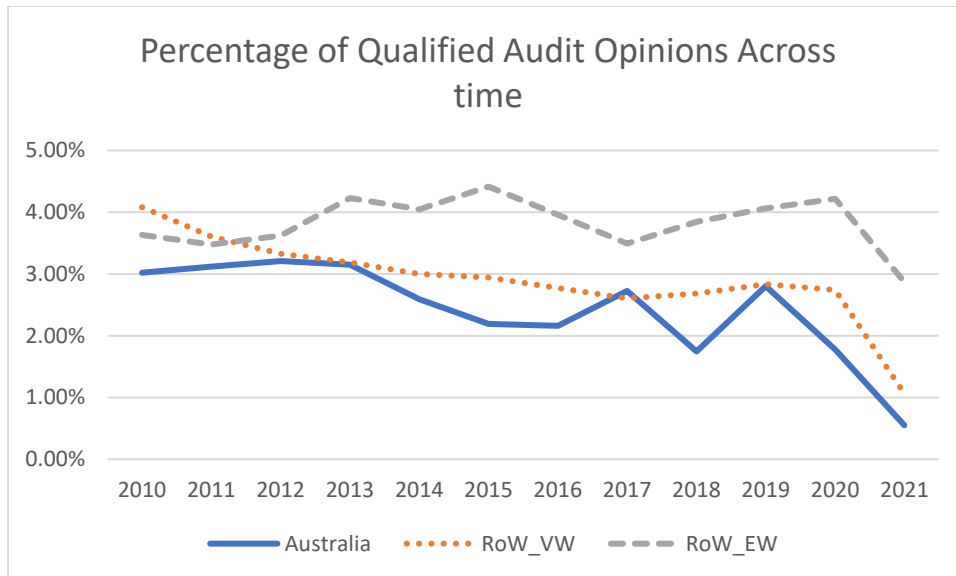
- For the 2021 reporting year, going concern is one of the more frequent KAM subject matter area representing 3% of all KAMS and occurring for 68 firms out of 1,400
- Of the 68 companies that had a going concern KAM only 13 had an MUGC opinion.
- The frequency of the GC KAMs is spread across the size distribution of Australian companies as follows: Large Companies (12%), Medium (32%), Small (27%) and Micro (29%).
- The frequency of GC KAMS is spread across all industries consistent with the underlying frequency of companies in each industry. See Table 5
- The financial performance and liquidity position of KAMS\_GC is worse than unqualified firms but better than firms with an MUGC. As an example:
  - the median ROA of each qualification type is -6.41% (Unqualified); -13.60% (KAM\_GC) and -21.52% (Emphasis).
  - the median CFO/Total Assets of each qualification type is: -0.02% (Unqualified); -0.07% (KAM\_GC) and -11% (Emphasis)
- Overall it appears that auditors are using GC KAMS to communicate 'not quite a MUGC, but still a potential problem'

## **7. Did the firms that had a MUGC or Going Concern\_KAM subsequently go into liquidation?**

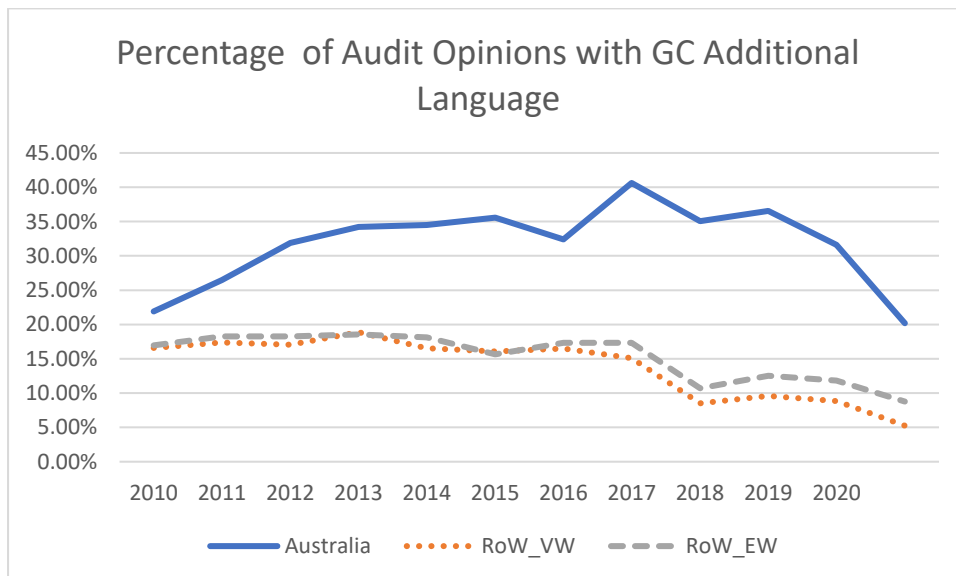
- As at 1<sup>st</sup> August 2022, only 1 of the 68 companies that had KAMs in 2021 had delisted (Q Technology Group Ltd).
- As at 1<sup>st</sup> August 2022, only 4% of the firms with MUGC opinions issued in 2021 had delisted
- Therefore, there is no evidence that MUGC are predicting liquidation for the median firm.

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**Figure 1**

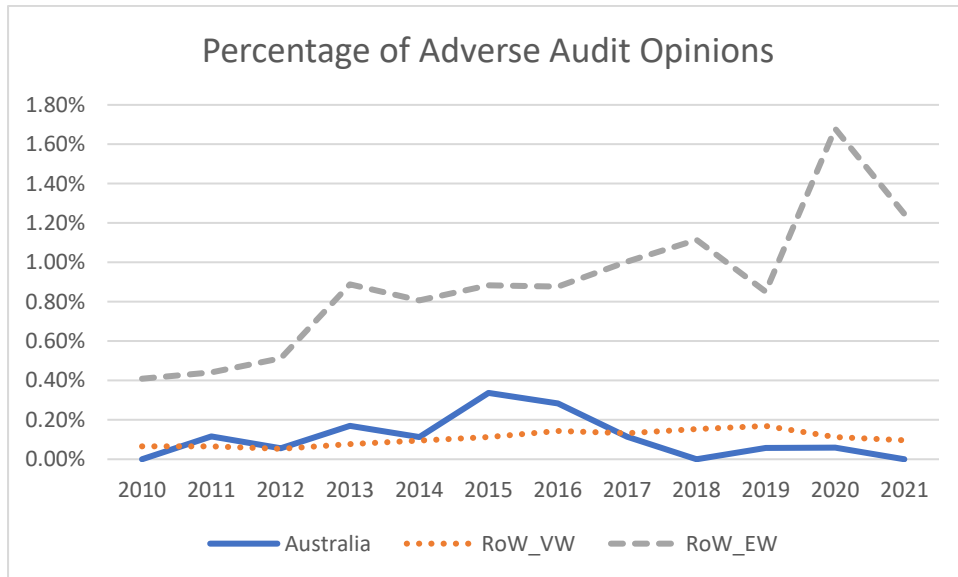


**Figure 2**



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**Figure 3**



**TABLE 1**  
**Percentage Frequency of Audit Opinions**

	2021				2010 to 2020			
	Obs	Australia	RoW_VW	RoW_EW	Obs	Australia	RoW_VW	RoW_EW
Unqualified	1296	79.27%	93.59%	89.65%	12410	64.43%	82.38%	81.40%
Qualified	9	0.55%	1.06%	2.87%	499	2.59%	3.04%	3.28%
GC_With Emphasis	330	20.18%	5.26%	8.77%	6329	32.86%	14.47%	15.61%
Adverse	0	0.00%	0.10%	1.25%	23	0.12%	0.11%	0.32%

ROW\_VW is Rest of World weighted by number of observations in each country

ROW\_EW is Rest of World where each country is equal weighted

**TABLE 2**  
**Frequency in 2021 of Material Uncertainty Related to Going Concern (MUGC) Across and Within Sectors**

Sector	Obs	Australia			World		
		Population Sector%	MUGC		Population Sector%	MUGC	
			Across Sectors*	Within Sector#		Across Sectors	Within Sector
Energy	117	8.69%	11.49%	30.09%	2.65%	6.69%	13.37%
Mining & Materials	567	42.09%	48.99%	26.32%	12.99%	12.94%	5.28%
Industrials	124	9.21%	5.74%	15.32%	23.91%	20.37%	4.52%
Consumer Discretionary	100	7.42%	4.39%	14.13%	17.63%	18.96%	5.70%
Consumer Staples	55	4.08%	1.69%	9.43%	7.92%	7.29%	4.88%
Health Care	142	10.54%	11.15%	23.91%	8.53%	9.44%	5.87%
Banking	19	1.41%	1.35%	21.05%	0.79%	0.82%	5.50%
Information Technology	142	10.54%	9.80%	21.32%	16.74%	12.64%	4.00%
Communication Services	57	4.23%	3.72%	19.64%	5.29%	6.17%	6.18%
Utilities	19	1.41%	1.35%	21.05%	2.61%	3.87%	7.87%
Real Estate	5	0.37%	0.34%	20.00%	0.93%	0.82%	4.64%
	1347	100.00%	100.00%		100.00%	100.00%	

\*The number of firms by industry sector classification with a MUGC opinion as a % of the total number of MUGC opinions

# The number of MUGC opinions within each sector as a % of the total number of firms in that sector

**TABLE 3**  
**Financial Performance and Position of Australian Firms in 2021 Across Audit Opinions**

	Unqualified Audit Opinions				Going Concern with Emphasis				KAM Going Concern			
	%	Median	Perc25	Perc75	%	Median	Perc25	Perc75	%	Median	Perc25	Perc75
<b>Panel A Percentage of Firms</b>												
Percentage Loss	63.68%				90.85%				79.63%			
Percentage CFO <0	56.41%				91.22%				75.93%			
Percentage Debt > 0	79.66%				74.66%				77.78%			
<b>Panel B Descriptive Statistics</b>												
Total Assets		44.02	13.82	230.88		12.65	4.91	31.91		24.86	9.45	62.83
%Sales Growth		6.44%	-17.35%	33.91%		-19.48%	-72.41%	17.54%		-0.65%	-22.27%	40.54%
ROA		-6.41%	-25.70%	4.02%		-21.52%	-58.06%	-7.70%		-13.60%	-40.54%	-2.34%
Leverage		0.04	0.00	0.20		0.04	0.00	0.37		0.09	0.00	0.29
Debt-Equity		0.06	0.00	0.37		0.01	0.00	0.26		0.04	0.00	0.57
Current Ratio		2.76	1.39	8.15		1.74	0.67	4.55		2.09	1.08	5.51
CFO/Total Assets		-0.02	-0.14	0.09		-0.11	-0.42	-0.04		-0.07	-0.31	-0.01
Interest Coverage		2.91	-36.34	13.44		-6.80	-75.02	-0.20		-2.39	-56.82	1.87
Observations	998				296				54			

**TABLE 4**  
**Frequency of Going Concern Audit Opinions across and within Audit Firm Portfolios**

	Obs	%Population	%MUGC		%KAM Going Concern	
			%Across Audit Firms*	% Within Audit Firm#	%Across Audit Firms	% Within Audit Firms
Ernst & Young	138	10.24%	9.80%	21.01%	9.26%	3.62%
Deloitte & Touche	89	6.60%	2.70%	8.99%	0.00%	0.00%
KPMG	103	7.64%	4.73%	13.59%	9.26%	4.85%
PricewaterhouseCoopers	86	6.38%	1.69%	5.81%	5.56%	3.49%
BDO	203	15.06%	23.65%	34.48%	12.96%	3.45%
Crowe Horwath	2	0.15%	0.00%	0.00%	0.00%	0.00%
Grant Thornton	100	7.42%	11.49%	34.00%	11.11%	6.00%
Moore Stephens	19	1.41%	1.69%	26.32%	5.56%	15.79%
PKF International	40	2.97%	4.05%	30.00%	3.70%	5.00%
Other	568	42.14%	40.20%	20.95%	42.59%	4.05%
	1348	100.00%	100.00%		100.00%	

\*The number of firms by auditor with a MUGC opinion as a % of the total number of MUGC opinions

# The number of MUGC opinions for each auditor as a % of the total number of the firms in the auditor's listed client portfolio

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**TABLE 5**  
**Frequency in 2021 of KAM Going Concern Across Sectors**

<b>Sector</b>	<b>Obs</b>	<b>Population Sector%</b>	<b>KAM % Across sectors</b>
Energy	117	8.69%	7.41%
Mining & Materials	567	42.09%	29.63%
Industrials	124	9.21%	24.07%
Consumer Discretionary	100	7.42%	14.81%
Consumer Staples	55	4.08%	3.70%
Health Care	142	10.54%	7.41%
Banking	19	1.41%	0.00%
Information Technology	142	10.54%	11.11%
Communication Services	57	4.23%	1.85%
Utilities	19	1.41%	0.00%
Real Estate	5	0.37%	0.00%
	1347	100.00%	100.00%