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AN ANALYSIS OF THE FINANCIAL REPORTING PRACTICES OF FINANCIALLY DISTRESSED SOUTH AFRICAN LISTED COMPANIES

by

EVANGELISTA MANGWIRO

A dissertation submitted in fulfilment for the Degree

of

Master's in Commerce

in

International Accounting

at the

College of Business and Economics

UNIVERSITY OF JOHANNESBURG

Supervisor: Mariska McKenzie

2020

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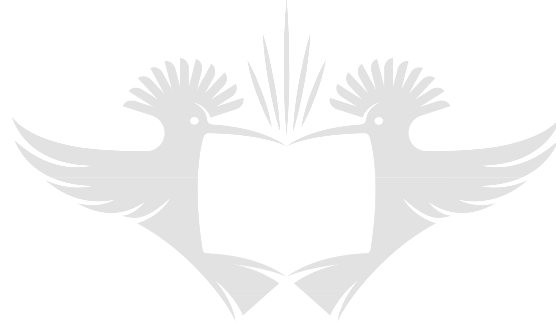
DECLARATION

I certify that the minor dissertation submitted by me for the degree *Master's of Commerce (International Accounting)* at the University of Johannesburg is my independent work and has not been submitted by me for a degree at another university.

EVANGELISTA MANGWIRO



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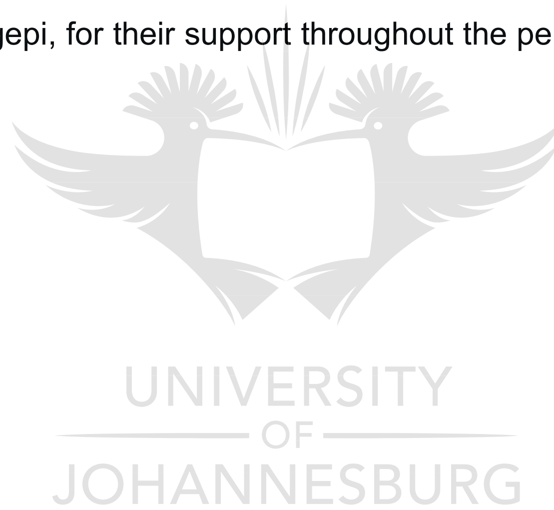
ACKNOWLEDGEMENTS

First, I would like to thank Professor Daniel Coetsee for assisting me to enhance my accounting knowledge through his detailed and open discussion lectures.

Second, I would like to thank my supervisor, Mariska McKenzie, for support during the period of writing my dissertation. She was positive all the way, and that assisted me in achieving my goals and improving my writing skills.

Thirdly, I would not have done this without the encouragement of my colleagues; particularly, Vimbai Murenga, Grace Muchirahondo, and Runyararo Makanza, as well as Professor Robert Garnett's providing more insights on *IFRSs*.

Lastly, I would like to thank my loving husband, Attwel Chamwarura, and my dearest mom, Ms Maria Toringepi, for their support throughout the period of the limited scope dissertation.



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ABSTRACT

Since the introduction of accounting concepts to the current generation, the ultimate responsibility of financial reporting has been to provide users of financial statements with quality financial information that is useful for decision-making purposes. In order to provide such information, the *International Financial Reporting Standards* (*IFRSs*) stipulate the type of financial disclosures to be provided by the entity, using the framework for each relevant accounting standard applicable to that entity. Since the rate at which large corporations are plunging into financial distress has increased enormously in recent years, the conditions causing this financial distress pose challenges to management when assessing whether the company is a going concern and to auditors when evaluating the adequacy of its going concern disclosures. The starting point is the financial reporting by management before auditors can audit and users can consider the financial information. It is therefore of utmost importance to examine the financial reporting practices of entities that may be in need of business rescue to identify significant trends in their disclosures that may assist in improving the financial reporting in such cases.

The study examined the going concern disclosures of financially distressed firms over three years to establish a trend of the location of disclosures, and the nature, timing and extent of the information disclosed. These elements have been taken for granted over the years yet are fundamental to the disclosures. The outcomes of the study indicate that going concern disclosures are located across all reports in the financial statements, but there is no consistency in where the information is disclosed. This is because the *IFRSs* do not provide guidance on the location of going concern disclosures.

Companies perform assessments at different times, and generally do not indicate how events and conditions are evaluated to determine their significance. Though this must be considered by auditors in assessing going concern disclosures, the *IFRSs* give no guidelines, nor do they provide guidelines on the range and depth of going concern disclosures that should be included by management; they leave this to the *IFRSs* requirements on judgements. There is no guidance as to the extent to which the assessments and material uncertainties should be disclosed.

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Companies tend to be more aggressive in providing disclosures in the year of actual business rescue, when they expand on their mitigating plans and the methods and robustness of their going concern assessments. Companies comply with the *IFRSs* and provide users of financial statements with information that enables them to make useful decisions. However, the quality of the disclosures varies from one company to the next, depending on the judgements applied.

This study assists management to provide adequate quality disclosures in financial statements, auditors to review going concern assessments, and users to consider the impact of the going concern information on share prices. The study is likely to result in either amendments to *International Accounting Standard 1* or the creation of a new general going concern disclosure standard. The International Accounting Standards Board may use this study when setting standards for the review of disclosures requirements and when developing disclosure requirements in new and amended standards.

Key words: Financial disclosures, financial distress, business rescue, financial crisis, voluntary disclosures

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TABLE OF CONTENTS

Acknowledgements ... iii
Abstract ... iv
List of Figures ... viii
List of Tables ... ix
Glossary of Terms and Abbreviations ... x
Chapter 1. Introduction ... 11
1.1 Background ... 11
1.2 Problem statement ... 19
1.3 Research objective ... 22
1.4 Motivation for this dissertation ... 23
1.5 Research methodology ... 23
1.6 Ethical considerations ... 25
1.7 Limitations of the study ... 26
1.8 Structure of the dissertation ... 26
Chapter 2. Literature review ... 27
2.1 Introduction ... 27
2.2 Accounting and auditing standards setters ... 27
2.3 Going concern assessments and opinions ... 37
2.4 Financial distress and disclosures ... 45
2.5 Conclusion ... 55
Chapter 3. Research Methodology ... 57
3.1 Introduction ... 57
3.2 Nature of study ... 57
3.3 Population and sample selection ... 58
3.4 Tools and methods ... 61
Chapter 4. Findings ... 64
4.1 Introduction ... 64
4.2 Location of the going concern disclosures ... 64
4.3 Timing of going concern assessments ... 67

UNIVERSITY
OF
JOHANNESBURG

المنارة للاستشارات
www.manaraa.com

4.4 Nature and extent of going concern disclosures in each location identified in relation to IAS 1 disclosure requirements and ISA 570 auditing guidelines ... 69
4.5 The quantum of going concern disclosures ... 82
4.6 Compliance with IAS 1 requirements per the IFRS checklist ... 85
4.7 Conclusion ... 85
Chapter 5. Conclusions and Recommendations ... 89
5.1 Introduction ... 89
5.2 Summary of findings and conclusions ... 89
5.3 Recommendations ... 91
5.4 Considerations for future research ... 92
Reference List ... 93

المنارة للاستشارات
www.manaraa.com

LIST OF FIGURES

Figure 2.1: Financial, operational and other indicators 32

Figure 4.1: Overall going concern disclosures in years 1, 2 and 3 81

Figure 4.2: Overall assessment of the quantum of going concern disclosures 84

المنارة للاستشارات
www.manaraa.com

LIST OF TABLES

Table 2.1: Comparison of accounting and auditing standards re going concerns 35
Table 2.2: Business rescue proceedings started per industry 47
Table 3.1: Companies under business rescue 60
Table 4.1: Location of going concern disclosures 65
Table 4.2: Overall assessment of the location of going concern disclosures 66
Table 4.3: Timing of going concern assessments 68
Table 4.4: Going concern disclosures 70
Table 4.5: Quantum of going concern disclosures 83
Table 4.6: Analysis of going concern disclosure compliance with IAS 1 85

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GLOSSARY OF TERMS AND ABBREVIATIONS

Throughout this document, unless otherwise stated, the words in the first column have the meanings stated opposite them in the second column.

TERMS	ABBREVIATIONS
AFSs	Annual financial statements
AICD	Australian Institute of Company Directors
ASC	Accounting Standards Codification
ASU	Accounting Standards Update
AUASB	Australian Auditing and Assurance Standards Board
CFAs	Chartered Financial Analysts
CIPC	Companies and Intellectual Property Commission
FASB	Financial Accounting Standards Board
FRIP	Financial Reporting Investigation Panel
FSs	Financial statements
GAAP	Generally Accepted Accounting Principles
GCA	Going concern assumption
IAASB	International Auditing and Assurance Standards Board
IASB	International Auditing and Assurance Standards Board
IAS	International Accounting Standard
IFRIC	International Financial Reporting Interpretations Committee
IFRSs	International Financial Reporting Standards
IRBA	Independent Regulatory Board for Auditors
ISAs	International Standards on Auditing
JSE	Johannesburg Stock Exchange
PCAOB	Public Company Accounting Oversight Board
SA	South Africa
US	United States of America

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CHAPTER 1. INTRODUCTION

The present study examined the going concern disclosures of financially distressed firms. The study focused on establishing a three-year trend in the location of the disclosures, and the nature, timing and extent of the information disclosed.

The chapter is a synopsis of the study, arranged in the following manner: first, the background of the study is discussed, second, the problem statement is outlined, thereafter the research objectives and motivation for research are explained, followed by the research methodology, then ethical considerations, and finally, limitations and structure of the study.

1.1 BACKGROUND

In South Africa, financially stable companies that were not considered to be “sinkable” had their foundations shaken due to the recurrent impact of the credit crunch that occurred in 2008 during a recession in the South African economy (Du Preez, 2012). Even though the economy is gradually recovering, 84 public companies suffered financial distress and filed for business rescue between 2011 and 2016, indicating the long-lasting impact that the financial crisis had on companies (Companies Intellectual Properties Commission [CIPC], 2016; Du Preez, 2012; Statistics SA, 2017).

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The Companies Act (no. 71 of 2008) defines *financially distressed* as follows “it appears to be: (a) reasonably unlikely that the company will be able to pay all of its debts as they fall due and payable within the immediately ensuing six months, or (b) reasonably likely that the company will become insolvent within the immediately ensuing six months”. Bruneli (2018) indicated two words that are frequently used to describe the current economic environment: transformation as well as uncertainty. The rapidity of transformation makes it more challenging to forecast the future.

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1.1.1 Disclosures in Financial Statements

It is during these times that everyone has become interested in what used to be considered unpredictable and impossible. During the time leading up to the 2008 financial crisis, investors perceived that financial disclosures provided were lacking in transparency about the risks, exposures and uncertainties pertaining to the institutions that collapsed. As such, the usefulness of financial reports was brought into question by investors during the financial crisis (Chartered Financial Analysts [CFAs] Institute, 2013; Coetsee, Haji, & Marx, 2012). This led to the introduction of *International Financial Reporting Standard (IFRS) 7, Financial Instruments: Disclosures*, which provides for disclosures on the identified nature and risks relating to the financial instruments.

According to Reback (2011), provision of disclosures in the financial reports in terms of *IFRS 7* affords users to envisage whether the financial instruments are significant, based on assessment performed of the type and size of risks that the company was exposed to throughout the year from the beginning to the end of the reporting period, and how the company handles the risks. *IFRS 7* has qualitative disclosure requirements which states the policies and processes for handling the identified risks.

Further information regarding magnitude of risk exposure is contained in the *IFRS 7* quantitative disclosure requirements. Management of the entity assess the information received internally against the guidelines of *IFRS 7*. Both statements together provide an explanation of the use of financial instruments and their related risks (Reback, 2011). *IFRS 7* is applicable to all entities and not based on the number of financial instruments in the financial statements (for instance, only accounts receivable, cash and accounts payable for a manufacturing entity and many financial assets for a financial services company).

IFRS 9, Financial Instruments, was issued by the International Accounting Standards Board (IASB) on 24 July 2014, and substituted *International Accounting Standards* (IASs) 39 *Financial Instruments: Recognition and Measurement*. When implementing *IFRS 9*, companies must disclose information around *IFRS* 9 implementation and its financial impact towards users of financial statements. *IFRS* 9 requires more disclosures on the approaches to modelling expected credit loss.

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Even though *IFRS 7* has been introduced, uncertain or challenging economic conditions have continued to have a significant impact on financial reporting, when management assesses the company's ability to remain as a going concern, according to the Australian Institute of Company Directors (AICD) and the Australian Auditing and Assurance Standards Board (AUASB) (2009).

According to Bruneli (2018), going concern matters have become more problematic to envisage and bankruptcies have increased, and transformation and uncertainties have become the basis for business life. According to the *IFRSs*, one of the underlying assumptions in preparing financial statements is that an entity is a going concern.

1.1.2 Going concern status

IAS 1, paragraph 25, of the *IFRSs* states that management should assess whether the company will continue as a going concern when preparing the financial statements. Challenging conditions pose difficulties to management in assessing the company's going concern status (AICD & AUASB, 2009).

For the purpose of this dissertation, *management* includes the preparers of the financial statements, the audit committee, and the board of directors.

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The inappropriateness of going concern basis will not automatically result in a 'break-up' basis (Hahn, 2011). In Hahn's view, it is only in rare situations that the 'break-up' basis should be used in the preparation of financial statements. Hahn (2011) indicates that this is due to the fact that the state of affairs of the business are only presented in the company's financial statements at the end of the financial year. For example, where a company in question reports quoted securities, it becomes problematic to record those securities at an amount below their fair value, although the assets are sold for a lesser amount subsequent to the reporting period. A loss on disposal after the reporting period indicates a decision to hold them rather than to sell them after year end. For the same thoughts, it

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is considered not to be appropriate to provide for future losses or liabilities in a case where there was no commitment by the end of the financial year.

In this situation, Hahn (2011) proposes that, although an entity made a decision to cease trading, it is recommended that a basis in line with *IFRSs* reflecting the inappropriateness of 'going concern' assumption be used, rather than a break-up basis. Hahn (2011) asserts that this encompass writing assets down to their recoverable amount, and providing for contractual commitments that may have become onerous as a consequence of the decision made by the company not to continue in existence.

1.1.3 Auditing the adequacy of disclosures

IAS 1, paragraph 25, of the *IFRSs* states that, if any material uncertainties cast doubt on the assessment made about going concern, the standard requires those uncertainties to be disclosed. Auditors face challenges during the audit when evaluating the adequacy of disclosures (AICD & AUASB, 2009).

Disclosure occurs when a company's financial as well as non-financial information is revealed in its financial report as required by legislation or professional pronouncements (Kabara & Kurawa, 2014). The disclosure of such information is mandatory, but in some instances financial information is disclosed voluntarily to users in the annual reports (Kabara & Kurawa, 2014).

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In June 2012, the IASB initiated a project pertaining to the disclosures about going concern status as provided by *IAS* 1, after the International Audit and Assurance Standards Board (IAASB) sent a request to the IASB requesting clarification. *IAS* 1 is not clear regarding the disclosure relating to the material uncertainties and the timing indicating when financial statements should be prepared on a going concern basis.

The IFRS Interpretations Committee came with a view that the IASB should come up with a scope amendment that is narrow in an attempt to alter the disclosure requirements in *IAS* 1 in answering to the matter; however, the IASB resolved not to pursue with the

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view. After deliberating until March 2014, the IASB issued a tentative agenda decision, regarding judgements applied when performing going concern assessments in instances of a ‘close call’ being an illustration of the application of judgements as per paragraph 122 of *IAS 1*.

In 2015 and 2016, the Independent Regulatory Board for Auditors (IRBA) raised findings on going concern issues in its inspection reports (IRBA, 2015; IRBA, Public inspection report, 2016). Some of the issues raised were that there was no documented consideration of the effect of the indicators on the audit opinion, no going concern considerations were documented, there were no documented procedures to support going concern conclusions, and a mismatch was found in the going concern opinion provided in the audit report and related auditors’ working papers. This constituted respectively less than one per cent and one per cent of the significant findings raised.

In 2017 and 2018, the IRBA raised issues on the inadequacy of *IFRS 7* disclosures but none on going concern disclosures (IRBA, Public Inspection report, 2018).

The Big Four auditing firms in South Africa are Deloitte, Ernst & Young, KPMG, and Price Waterhouse Coopers (Fernandez-Feijoo, Romero, & Ruiz, 2015). Deloitte was summoned to a disciplinary hearing by the IRBA when it issued a going concern status to the African bank and having given unqualified reports on its financial statements, although this was not so, based on the conditions and events of the bank (IRBA, 2018). This has raised eyebrows in the history of auditing and accounting.

Auditors evaluate an entity’s going concern status based on *International Auditing Standard (ISA) 570 (Revised), Going Concern*, which stipulates auditors’ responsibilities when auditing going concern disclosures and drawing up the resulting conclusions in their report. *ISA 570* states that going concern assessments involve making a judgement about future results in uncertain conditions. When evaluating a company’s going-concern position, auditors need to take into consideration the prospective forecasts of earnings provided by management.

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1.1.3.1 *Forecasts*

Forecasts of management earnings indicates plans put in place that may be implemented by management in order to generate cash flow and profits, and consequently may be informative to auditors. In that regard, managers may be forced to produce biased forecasts, which in turn may pose an impact on the auditors when evaluating the going-concern position of a company.

Managers of financially distressed entities are likely to issue optimistically biased earnings forecasts in an effort to reduce the chances of attaining negative going concern opinions. Consistent with this, it appears that management forecasts are more optimistically biased when there is higher probability of entities attaining a negative going concern opinion. This optimistic bias is economically substantial, as, on average, managers are 18 per cent more likely to issue an optimistic forecast if the chances of attaining a negative going concern opinion rises by one standard deviation.

1.1.3.2 *Opinions*

Mutchler (1985) alluded that the decisions of the stakeholders are based on the going concern opinions issued, thus may impose significant economic costs on the audit clients. The negative opinions become costly to firms, due to the fact that they may result in significant negative market reactions (Blay & Geiger, 2001) and increased challenges in conducting business with providers of resources (Mutchler, 1985).

The AICD (2019) states that the information in the disclosures need to be extended as information on liquidity risk and going concern assessments is received by the entity. Problems of gauging the effect of the assessment on market prices arise if information on liquidity risk and going concern assessments is not adequately disclosed. The IASB (2017) points out that financial statements are tools for company managers to communicate with their investors.

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1.1.4 Investors

Investors need to understand the information in the financial statements in order to make decisions regarding the provision of resources to that company (IASB, 2017). This financial information is found in the annual reports which are comprised of the auditor's report, the directors' report, a cash flow statement, a statement of changes in equity, a statement of financial performance and a statement of financial position, as well as explanatory notes.

The said reports and notes normally expound on significant circumstances or events, while the statements portray suitable economic occurrences in words and amounts (Barth, 2014). Through analysis of the financial information, providers of capital are able to understand the profitability position of the company, which enables them to come up with investment strategies that will lessen any losses related to their investment (Bose, Chen, & Geng, 2014).

1.1.5 Financial distress

There is regarded to be a substantial negative link between financial distress and the level at which disclosures are made in the financial statements, particularly, voluntary information (Gantyowati & Nugraheni, 2014).

Companies disclose positive or negative information or growth strategies, as well as foreseeable financial and business risks. Positive information impresses investors and may result in improving the value of the company, thereby increasing share price. Negative information is limited when management is in a financially distressed situation as managers tend to be reserved in an effort to preserve the value of the share price (Gantyowati & Nugraheni, 2014). There are two conflicting theories that have previously been attributed to this behaviour; these are agency and signalling theories.

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Signalling theory states that a financially distressed company sets boundaries and limits information to the public; whereas agency theory sees companies with bad news disclosing voluntary information in their annual reports in an attempt to curb future costs that may arise and avoid bankruptcy (Gantyowati & Nugraheni, 2014).

Before a company reveals its state of financial crisis, that is, liquidity, solvency and profitability issues, financial statements are often misrepresented (Dzyuma-Zaemba, 2015). For example, the United States (US) company, Lehman Brothers Incorporated, misrepresented disclosure pertaining to repossessions and related transactions before its collapse during a global financial crisis. It did not disclose significant events as per the US *Generally Accepted Accounting Principles* (GAAP). This abuse of repossessions resulted from inadequate and unclear accounting standards to guide the transactions that led to the collapse of Lehman Brothers (Adu-Gyamfi, 2016; Du Preez, 2012).

Misrepresentation or limiting useful information to users defeats the very purpose of the *IFRS Conceptual Framework for Financial Reporting* of the IASB, which indicates that financial information is useful to its users when it faithfully represent what it purports to represent and is relevant. The IASB indicates that comparability, timeliness, understandability and verifiability enhance the usefulness of financial information.

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1.1.6 Understandability

Companies may disclose a lot of information, which in many cases obscures the true financial position of a company. However, information about growth opportunities, risks, strategic direction is required by investors, which can be analysed by tools that handle any size of any statistical data in order to interpret it (Singh, 2013).

Recently, the IASB (2017) was notified of concerns by users regarding information companies disclose in their annual financial statements and the way in which those financial statements met various users' needs. One of the three main disclosure problems

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identified by the IASB was that there is inadequacy of relevant financial information, which has led to incorrect investment decisions. The concerns raised by the users are still under discussion by the IASB, as it has published a Discussion Paper titled "DP/2017/1 *Disclosure Initiative—Principles of Disclosure"* in March 2017. The paper addresses the old and new disclosure principles in an effort to enhance the effectiveness of communication of financial disclosures for useful decision-making. The discussion paper was birthed after the deliberations on going concern assessments by the IASB, as noted above (IASB, 2018). When disclosures and information provided by management in the financial reports pertaining to going concern issues are understandable by the users of financial statements, that determines their quality (AICD & AUASB, 2009).

Disclosure of adequate financial information about impending financial distress is imperative for investors to prepare for it beforehand, by making informed capital investment decisions. Relying on the financial information subsequent to business rescue may be inadequate and too late for making useful decisions (Holtzhauzen & Pretorius, 2013).

1.1.7 Business rescue

Business rescue is defined in the Companies Act (2008) as a process where actions are undertaken to support the recovery of a company that is financially distressed (South Africa [Republic], 2008). Financial distress therefore has a direct impact on investors as they tend to incur significant costs and lose their investments if a company ends up going into liquidation (Gantyowati & Nugraheni, 2014; Tuvadaratragool, 2013).

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1.2 PROBLEM STATEMENT

The Companies Act No. 71, 2008, paragraph 128 (f) states that a company is financially distressed when it is likely to have liquidity and solvency problems in the next six months. The liquidity and solvency problems are mainly communicated to the users of financial statements through the application by management of *IAS 1* and *IFRS 7*, which was amended by the introduction of *IFRS 9*.

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As previously noted, when a company has liquidity and solvency problems, this affects management, auditors and users. Management is affected when assessing going concern status and disclosing it in their financial statements, auditors are affected when evaluating the adequacy of the disclosures, and users are affected when making investment decisions upon the basis by which the financial statements are prepared. Companies that are undergoing financial distress must provide sufficient financial disclosures for investors to make informed capital investment decisions. Without the warning signs provided by adequate financial disclosures pertaining to the financial distress, investors are likely to lose their investments if the company ends up in bankruptcy.

Financial disclosures, particularly for financially distressed companies, are quite minimal when compared to those of non-financially distressed companies (Vishnani & Shab, 2007). There is a tendency for management to make disclosures to its owners that are not adequately transparent about a company's performance, especially when there is impending financial distress; this is due to an agent problem or conflict, as both parties work towards maximisation of profits, resulting in information asymmetry (Gantyowati & Nugraheni, 2014; Juhmani, 2013). According to the IASB (2013; 2016), the drive for producing financial reports is essentially to lessen information asymmetry between management and their related parties by means of disclosing relevant and timely information.

Edirin and Edesiri (2016) investigated the potential impact of the *IFRSs* on banks, where the accounting process connected to a bank's financial reporting is critical to users, such as auditors, bankers, corporate management, financial analysts, investors, leaders, regulators and accountants.

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Through financial statements, the financial state of affairs of organisations, is communicated to all kinds of stakeholders (Ginesti & Onali, 2014). According to the Financial Accounting Standards Board (FASB) of the IASB (2008), the *International Financial Reporting Standards (IFRSs)* are a set of accounting standards developed by the IASB for the preparation and presentation of public financial statements. The primary objective of financial reporting based on the *IFRSs* is to produce financial information that is of high quality concerning economic firms, principally monetary in nature, useful for economic decision-making. During their development, the *IFRSs*

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went through a rigorous due diligence process and are currently used in more than 120 countries around the world, including Australia, Canada, the European states, South Africa and many others (Ginesti & Onali, 2014).

Research has been undertaken in South Africa (Coetsee et.al., 2012; Dzeke, 2018) and other countries (Tauringana & Chithambo, 2016; Abraham & Cox, 2007) on the examination of the disclosures of financial instruments by nominated entities on the Johannesburg Stock Exchange (JSE), particularly focusing on *IFRS 7*, *Financial Instruments: Disclosures*.

In addition, research has been undertaken on going concern audit opinions (Amin, Krishnan & Yang, 2014; Bédard, Brousseau & Brousseau, 2019; Breesch, Hardies & Vandenhaute, 2018; Desai, Desai, Kim & Srivastava, 2017; Geiger, Raghunandan & Riccardi, 2014; Popova & Stein, 2016). Lopez-Corrales, Mareque and Pedrosa (2017) did a year-on-year trend analysis of the types of opinion issued between 2007 and 2010 for Spanish companies. However, year-on-year trends in the practices of financial reporting have not been dealt with adequately.

Cohen and Webb (2007) studied the quality of the discussions by management and disclosure analysis for a sample of firms entering financial distress. They evaluated how the financial disclosures of financially distressed companies changed, based on ethical and economic concerns. They discovered that the quality and number of disclosures increases just before financial distress commences and, when the company recovers from the financial distress, the increase in disclosure quality is sustained. They concluded that the changes in disclosure are as a result of economic situations instead of ethics, particularly in good economic times.

There is inadequacy of research in the South African context, particularly with regard to *IFRS 7* credit risk disclosures on the approaches to modelling expected credit losses, since the introduction of the *IFRS 9: Financial Instruments*. Further, there is limited research on going concern disclosures by South African listed companies before business rescue status.

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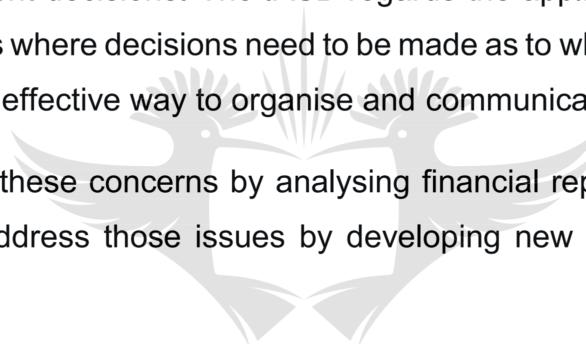
Business rescue is a process where actions are undertaken to support in the recovery of a company that is financially distressed (Companies Act, no. 71 of 2008). Basically, business rescue is a process that assists the company's liquidity and solvency position. If companies cannot be assisted during the business rescue process, they end up being liquidated.

The question to be asked therefore is whether there are any significant trends relating to the financial disclosures, that merit analysis (Balgrie, 2014). This would establish whether there is a need to improve financial reporting, thereby granting providers of capital, the opportunity to make fairly informed investment decisions. The IASB regards the application of judgement as the main issue for the preparers of financial statements in instances where decisions need to be made as to what information should be included, or excluded from, the financial statements, and the most effective way to organise and communicate it.



The focus of this research is to respond to these concerns by analysing financial reporting practices for a better understanding of disclosure issues, to enable the IASB to address those issues by developing new disclosure principles or clarifying the existing principles.

1.3 RESEARCH OBJECTIVE

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The primary objective of this dissertation is to analyse the financial statements of South African listed companies that went into business rescue in order to identify significant trends relating to their going concern disclosures.

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1.4 MOTIVATION FOR THIS DISSERTATION

The conclusions drawn from this dissertation will be a value add to the body of knowledge in the accounting arena. The outcomes derived from this research will contribute to assisting:

a) the IASB to make revisions to *IAS 1* or to develop a new standard that will add on existing principles or clarify the existing disclosure principles;
b) investors by ensuring financial information contains warnings of financial distress so they can make informed decisions regarding their investments;
c) auditors when evaluating the adequacy of going concern disclosures when formulating the audit opinion; and
d) regulators such as the JSE to regulate certain disclosure information apart from the *IFRSs*.

1.5 RESEARCH METHODOLOGY

1.5.1 Data source

Secondary data was used for this research: A list of South African companies listed on the JSE that underwent business rescue during the period 2015 to 2019 was extracted, from which certain companies were selected based on certain characteristics. The annual financial statements of the companies were analysed.

1.5.2 Data collection

Salkind (2014:223) states that “data about the topic need to be collected and analysed to test the viability of the hypotheses”. The audited reports of the selected companies were collected from the companies’ websites. Because these companies were listed, their annual financial statements were subjected to statutory audits, so the data was considered reliable and valid.

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1.5.3 Population and sampling

The population consisted of all companies listed on the JSE that underwent business rescue between 1 January 2015 and 31 December 2019. Further analysis is done in Chapter 3. “A sample frame is the list of elements from which the sample is drawn” (Blumberg, Cooper & Schindler, 2014: 174).

1.5.4 Data approach and analysis

This section describes the research philosophy, sometimes referred to as the research paradigm. A “research paradigm is a perception based on the set of shared assumptions, values, concepts and practices” (Johnson & Christensen, 2005). Furthermore, a research paradigm is the examiner’s viewpoint on the development of knowledge in conducting studies effectively (Johnson & Christensen, 2005).

According to Beckman, Cook, Harris, O’Brien and Reed (2014), “research models incorporate the fundamental theoretical concepts and values about the nature of reality and the scientific pursuit of knowledge”. Researchers needs to have an understanding of what constitutes the research paradigm. ”It should reflect the overall goals or objectives of the research, which in turn frame specific research questions, and are underpinned by particular ontological and epistemological positions” (Beckman et al., 2014). There are methods as well as philosophies included in the research paradigm. The combination of these philosophies assists the researcher in understanding research topic (Beckman et al., 2014). “Research paradigm has different terminologies such as positivism, interpretivism, phenomenological and realism research philosophies” (Edirisingha, 2012).

This research was undertaken in the peripherals of the interpretative paradigm because its objective was to analyse the audited financial disclosures of the companies listed on JSE that underwent business rescue, and to provide an interpretation of the results. Lewis, Saunders and Thornhill (2012) defined interpretivism as when the author understands disparities between individuals in our

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role as social sectors. A mixed-method approach was used in analysing the financial disclosures in order to corroborate different views. Bala, Brown and Venikatech (2013) defined an approach known as mixed-method approach as one that encompasses the use of both qualitative and quantitative research methods in the research process.

Lewis et.al. (2012) defined qualitative research as an approach where relationships are studied using various means of collecting data in an analytical review process that results in the development of a framework that is conceptualised. A qualitative content analysis as an approach whereby patterns are systematically identified in the process of interpreting the content of the data in text format (Hsieh & Shannon, 2005). A qualitative approach was applied, which entailed a systematic content analysis of the financial disclosures of companies for which business rescue was impending (focusing on going concern per *IAS 1*). The analysis used a disclosure checklist as per the guidance of IAS 1.

Lewis et.al. (2012) defined quantitative research as a form of research where the relationships between different numerical variables are examined using statistical methods. A quantitative approach was applied to the results of the financial disclosure analysis to form the basis of the conclusions. The approach used by Coetsee et.al., 2012 was applied and adjusted where necessary.

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1.6 ETHICAL CONSIDERATIONS

Confidentiality must be observed in dealing with company information (Denscombe, 2007), permission must be obtained where necessary, and identities protected. The financial information used was found in the public domain so no permission was required to use the data. The results of this research are unlikely to cause harm to anyone as this constitutes an analysis of publicly available information. According to Denscombe (2007), where individuals studied do not suffer harm as a result of being observed, it means ethical codes were adhered to.

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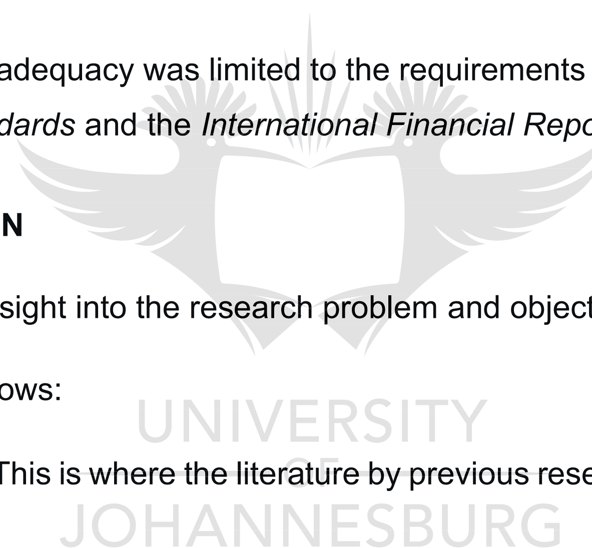
Ethical conduct was at the heart of this research, that is, other researcher's work was acknowledged, and facts were not falsified in interpreting data. The author of this research applied integrity and competency in undertaking the research.

1.7 LIMITATIONS OF THE STUDY

South African JSE-listed companies were used in undertaking this research. Financial distress for the purposes of this research was related only to listed companies that went into business rescue.

The analysis of the financial disclosures for adequacy was limited to the requirements of the Companies Act, no. 71 of 2008, and the guidelines of the *International Auditing Standards* and the *International Financial Reporting Standards*.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1.8 STRUCTURE OF THE DISSERTATION

The introduction in Chapter 1 provides an insight into the research problem and objective and justifies the research methodology.

The following chapters are structured as follows:

- Chapter 2 contains the literature review. This is where the literature by previous researchers and professionals on the research topic is reviewed.
- Chapter 3 explains the methods used in collecting, analysing and interpreting data.
- Chapter 4 provides information regarding the results of the examined data in line with the objective of the study.
- Chapter 5 draws conclusions and makes some recommendations based on the literature review and information collected during the research process.

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CHAPTER 2. LITERATURE REVIEW

2.1 INTRODUCTION

There has been ongoing debate pertaining to going concerns, from the preparation of their financial statements, to the auditing of those financial statements and the issuance of the audit report (Bruneli, 2018).

This chapter first reviews the literature by previous researchers who provided their views regarding the accounting and auditing standard setters and their requirements pertaining to going concerns. Secondly, the chapter provides literature on going concern assessments and going concern opinions. Finally, the chapter covers an overview of disclosures, particularly those of financially distressed companies.

A literature review involves documenting, analysing and reaching conclusions regarding a particular field of study (Machi & McEvoy, 2016). Links are made between texts from the sources referenced from the position of the researcher, as well as research amid these sources, thus forming part of a thesis (Ridley, 2012). According to Ridley (2012), a literature review is crucial in putting the researcher's work into context, in unfolding what the research entails and in providing a foundation for the research.

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2.2 ACCOUNTING AND AUDITING STANDARDS SETTERS

2.2.1 Requirements pertaining to going concerns

The two main regulatory accounting settings include the IASB and the FASB (Bruneli, 2018). The two main regulatory auditing settings include the International Auditing and Assurance Standards Board (IAASB) and the Public Company Accounting Oversight Board (PCAOB) (Bruneli, 2018). Clikeman (2018) indicated that, subsequent to the global financial crisis, auditors received criticism for

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failing to pay attention to the problems of a client’s users. The polemics regarding the audit profession, which decreased user’s confidence in audit reports, led to a revolution of audit developments (Cordos & Fülöp, 2014). This led Cordos and Fülöp (2014) to investigate users’ opinions of the IAASB’s latest audit reporting views regarding the revision of the ISA 570. Their study found that there were still concerns and that the expectation gap remained, but it saluted the revision process by the IAASBs. The revised ISA 570 has been available since 2015.

Clikeman (2018) revealed that the IAASB and the FASB subsequently took the bold step of issuing auditing standards which outlines responsibilities of auditors and management in assessing the company's ability to continue as a going concern. This step taken by the IAASB and the FASB brings America so close to conforming with the international standards.

The first going concern statement titled *Statement of Financial Accounting Concepts No.1* was issued in November 1978. The FASB amended it on 27 August 2014 in the *Accounting Standards Update (ASU) No. 2014–15, Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern*. The *ASU 2014–15* is under codification as *Accounting Standards Codification (ASC) 205-40* (Booker & Booker ,2016). The standard specifically requires key management to evaluate going concern position of the entity and provide disclosures in the notes to the financial statements when appropriate, which become informative to auditors during the audit (Booker & Booker ,2016).

Bruneli (2018) indicated that a specific going concern standard was issued by the IASB due to the explicit nature of the underlying assumption within the *Conceptual Framework for Financial Reporting*. The last update for the Conceptual Framework’ was released in 2010, and is currently under review (Bruneli, 2018). Regarding going concern updates, the PCAOB generally follows after the IAASB and the IASB generally follows after the FASB (Bruneli, 2018).

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2.2.2 Understandability

In terms of the FASB, it is the responsibility of management to providers disclosures that constitutes understandable information to the users. The information should include the applicable conditions and events that results in the assessment of whether there is substantial doubt about the entity's ability to continue as a going concern, the impact of those conditions and events through evaluation of the significance of those conditions and events, and any mitigating factors (Fitzsimons, Pappas & Ramanujam, 2009). These authors added that management needs to consider whether the operations may discontinue, whether plans should be put in place to alleviate the results of the uncertainties, and whether management's plans lessen the substantial doubt about its ability to continue as a going concern. They advised that management should also consider whether the assets recorded will be recovered and liabilities paid when they fall due.

Booker and Booker (2016) indicated that management should provide specific disclosures that show that the plans to alleviate substantial doubt. There are two questions that management must ask regarding these plans: whether it is likely that the plans will be executed successfully, and whether there will be mitigating events and conditions that raise doubt in the next 12 months. When the answer is positive, a disclosure note to that effect should be provided, with an overall assessment of alleviation of substantial doubt, which includes consideration of the plans, the challenges faced, and how the significance and plans that alleviate those challenges are evaluated. If the answer is negative, the same process should be followed.

2.2.3 Going concern assumption

According to the IFRS conceptual framework of the IASB, one of the underlying assumptions in preparing financial statements is that an entity is a going concern. Bruneli (2018) stated that going concern assumption is perhaps the most important assumption in the preparation of financial statements. Eickemeyer and Love (2016) indicated that there is a fundamental view in financial reporting that the company is assumed to continue in existence to discharge its liabilities and utilise its existing assets in the normal course of

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executing business. Management and auditors should ensure that they are trusted by stakeholders by communicating the ability of the entity to continue its existence in a sustainable system through a detailed process and procedures (Bruneli, 2018).

The IASB (2018) in *IAS 1, Presentation of Financial Statements*, states the following regarding going concerns:

> *When preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading or has no realistic alternative but to do so. When management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties (IASB, 2018; IAS paragraph 25).*
>
> *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, 12 months from the end of the reporting period. 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, the entity may reach a conclusion that the going concern basis of accounting is appropriate 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 (IASB, 2018; IAS paragraph 26).*

In evaluating the reasonability of the going concern assumption, microeconomic and macroeconomic projecting play an important role (Eickemeyer & Love, 2016).

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2.2.4 Material uncertainty

On the other hand, *ISA 570* of the IAASB standards states the procedures for evaluating the adequacy of disclosures where events and conditions have been identified and material uncertainty exists and where material uncertainty does not exist. *ISA 570* states that, where material uncertainty does not exist, auditors should review the events and conditions where management evaluated significance, the plans to mitigate them, and the significant judgements applied in going concern assessment. In instances where material uncertainty exists, review the events and conditions, their magnitude, likelihood and timing as well as significant judgements applied in going concern assessment. *ISA 570* provides examples of conditions and events that may cast doubt on the ability of the entity to continue as a going concern.

Lentner and Zéman (2018) provided Figure 2.1 indicating the composition of financial, operating and other indicators in the going concern assumption (GCA) applied by management.

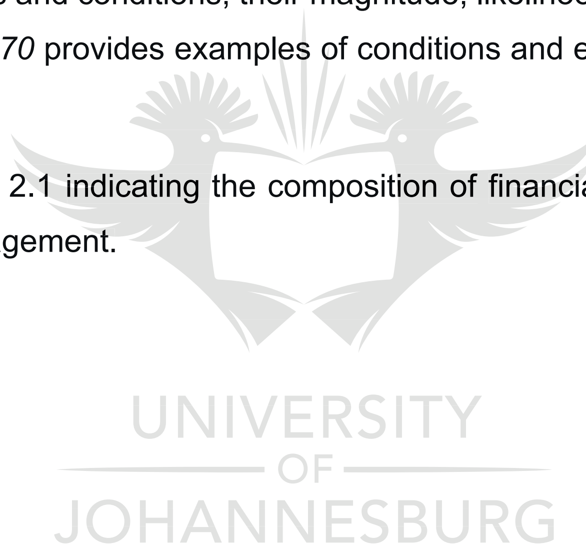
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Figure 2.1: Financial, operational and other indicators

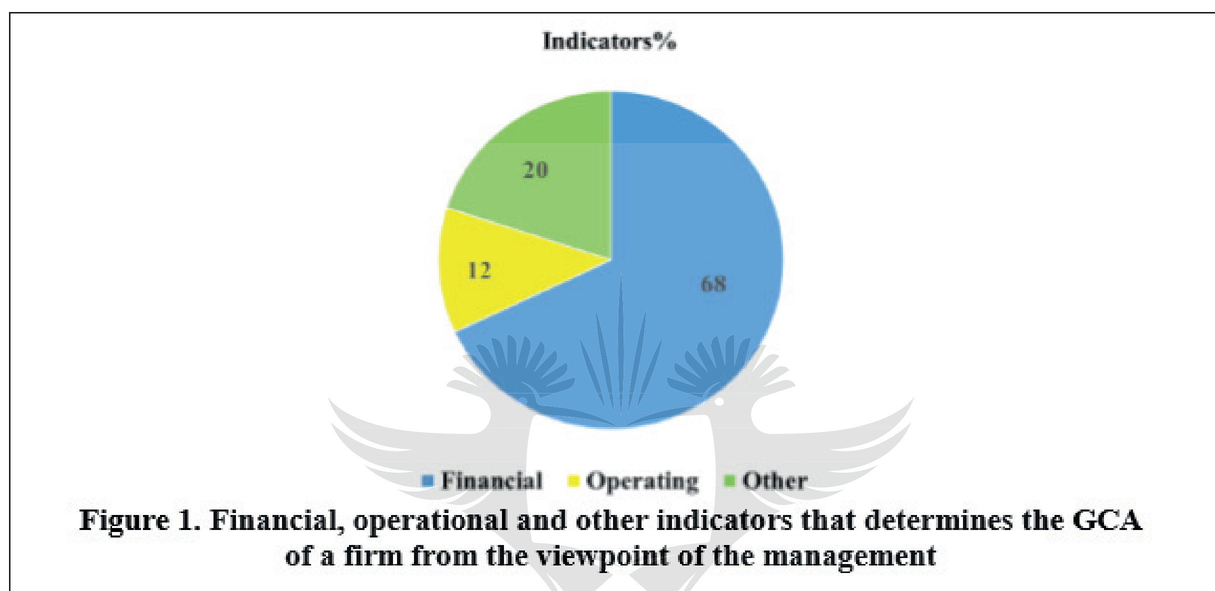

Figure 1. Financial, operational and other indicators that determines the GCA of a firm from the viewpoint of the management

Source: Lentner and Zéman, 2018

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The examples of financial, operating and other indicators provided in *ISA 570* include:

- ***Financial***: liability or net current liability position, fixed-term borrowings impending maturing with no projections of renewing, withdrawals of financial backing by creditors, adverse operating cash flows, negative key financial ratios, significant operating losses, decrease in resources that generate cash flows, amount outstanding of dividends, discontinued dividends, inability to pay creditors on due dates, inability to comply with the terms of the loan agreements, change from credit to cash-on-delivery transactions with suppliers.
- ***Operating***: intention to liquidate, loss of key suppliers, loss of market, and scarcity of suppliers.

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- ***Other***: non-adherence with capital, regulatory and statutory requirements, pending lawful and regulatory proceedings, changes in law affecting entity, uninsured catastrophe when they occur.

ISA 570 *states that negative indicators may be mitigated by other factors; for example, if it is unable to pay a debt, the entity may dispose of assets, reschedule loan repayments and obtain additional capital. Sean and Tsay (2015) compared the auditing standards (*AU-341, AU-C570 *and* ISA-570*) and accounting standards (*IAS 1, ASU 2014–15 *and* ASC 205–40*).*

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Table 2.1 below indicates the differences in their guidance re going concerns.

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Table 2.1: Comparison of accounting and auditing standards re going concerns

EXHIBIT: Comparison of Standard Guidance on Going Concerns				
Item	**ASU 2014 – 15 (ASC 205 – 40)**	**IAS 1**	**AU 341(AU – C – 570)**	**ISA 570**
Going Concern Presumption	Not specifically defined. Going concern is presumed until liquidation is imminent.	Going concern is presumed unless management either intends to liquidate the entity or ceases trading or has no realistic alternative but to do so.	Not specifically defined. Going concern is presumed unless evidence to the contrary relates to the firm's inability to continue.	Going concern is presumed unless management either intends to liquidate the entity or cease operations or has no realistic alternative but to do so.
Substantial Doubt/Significant Doubt	It is probable that the entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued (or available to be issued).	Not defined.	Not defined, although sample indicators are provided.	Not defined, although sample indicators are provided.
Assessment Date	Relevant conditions and events that are known and reasonably knowledge at the date that the financial statements are issued (or available to be issued).	Not defined.	Conditions at the date of the auditor's report (on or around financial statement issuance date).	Not defined.
Look-Forward Period	Within one year after the date that the financial statements are issued (or available to be issued).	At least, but not limited to, 12 months from the end of the reporting period.	A "reasonable period of time" not to exceed one year from the balance sheet date.	Same as the going concern time used by management, but at least 12 months from the date of the financial statements.
Disclosure Before Substantial Doubt or Additional Disclosure	• No disclosure before substantial doubt. • When management identifies conditions or events that raise substantial doubt about an entity's ability to continue as a going concern, management should consider whether the plans that are intended to mitigate those relevant conditions or events will alleviate the substantial doubt.	• Required to disclose uncertainties that caused significant doubt. • Required to disclose the fact that financial statements are not prepared on a going concern basis.	• No disclosure before substantial doubt. • Disclosures are considered (but not required) when management alleviates substantial doubt.	• An auditor is required to investigate factors that may cast significant doubt about going concern status. • Requires written representation from management about their plans for future action and their feasibility.

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EXHIBIT: Comparison of Standard Guidance on Going Concerns				
Item	**ASU 2014 – 15 (ASC 205 – 40)**	**IAS 1**	**AU 341(AU – C – 570)**	**ISA 570**
Disclosure Content	• If the substantial doubt is alleviated as a result of management's plans, the entity should disclose: • the principal conditions or events that raised substantial doubt,	• When management is aware of material uncertainties that might cast significant doubt about the going concern status, the entity is required to /…	• If there is substantial doubt or if management alleviates substantial doubt, disclose: • principal conditions, • possible effects,	• If material uncertainties exist, disclose factors that cast significant doubts on a going concern basis.
Disclosure Content continued…	• management's evaluation of their significance, and • management's plans that alleviated substantial doubt about the entity's ability to continue as a going concern. • If substantial doubt is not alleviated as the result of management's plans, then an entity should include a statement in the notes indicating that there is substantial doubt about the entity's ability to continue as a going concern. The entity should also disclose: • the principal conditions or events that raised substantial doubt, • management's evaluation of their significance of those conditions or events, and • management's plans that alleviated substantial doubt.	…/ disclose those uncertainties. • When an entity does not prepare financial statements on a going concern basis, it is required to disclose the fact, and the reason it is not regarded as a going concern.	• management evaluation, • possible discontinuation of operations, • management's plans, and • information about recorded assets or liabilities.	• If adequate disclosure is made in the financial statements, the auditor expresses an unmodified opinion but includes an Emphasis of Matter paragraph in the report. • If adequate disclosure is not made, or the going concern assessment is not adequate, the auditor is required to issue either a qualified or an adverse opinion.

Source: Adapted from (CPA, 2016)

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There are many disparities discovered by Booker and Booker (2016) between the *ASU 2014-2015* and its related auditing standard. The *ASU 2014-15* included the definition of substantial doubt and inserted a "probable" (likely) threshold in the definition, whereas the auditing standard merely provides a sample of indicators of substantial doubt but does not provide a definition (Booker and Booker, 2016). In conclusion, Booker and Booker (2016) indicated that FASB provided a definition of substantial doubt in an effort to reduce the subjectivity in interpretation that may be inherent in the auditing guidance.

Another key disparity that Booker and Booker found was that *ASU 2014-15* requires key management to assess substantial doubt annually and in each interim reporting period, while the auditing standard generally provides for an annual assessment. In that regard, they concluded that *ASU 2014-1* focus more on relevant information for the companies that issue interim FSs, thus rolling the assessment.

The other disparity they found was that the *ASU 2014-15* utilises one year from the date that the financial statements are available to be issued or issue, and auditing standards utilises one year from the statement of financial position date, yet both standards have one-year forward-looking periods. In their conclusion, they indicated that *ASU 2014-15* provides a more relevant going concern assessment than the auditing standards.

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While there is an auditing standard that sets the responsibility of auditors to evaluate whether the disclosures about going concern uncertainties are sufficient, there is no financial reporting standard for such disclosures, leading to disparities in the extent, nature and timing of disclosures in practice (Edmonds, Leece & Penner, 2016). Despite the disparities between the auditing standards and the accounting standards, the board of directors is required to carry out going concern assessments.

2.3 GOING CONCERN ASSESSMENTS AND OPINIONS

2.3.1 Going concern assessments

According to Venuti (2004), the board of directors is responsible for carrying out a going concern assessment in line with the relevant financial reporting framework as well as making related disclosures in accordance with that same framework. The assessments

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made require judgement. *IAS 1*, paragraphs 122–125, requires disclosure of judgements, including those involving estimates, that may cause the book values of assets and liabilities to be materially adjusted within the next financial year. In instance where estimates have been made, with regard to those assets and liabilities, the following details shall be included in the notes: (a) their nature, and (b) their book value as at the end of the financial year, together with assumptions and judgements management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements. Going concern assessment may produce information regarding, amongst others, turnaround activities and discontinued operations.

2.3.1.1 Turnaround activities

In the going concern assessment, management may supply information regarding its restructuring process where necessary, which is provided for in *IAS 37*, *Provisions, Contingent Liabilities and Contingent Asset*. Hoberg, Pesch and Steinker (2016) stated that, as financial distress threatens the survival of the firm, firms are forced to undertake appropriate turnaround activities. In the event that a company is approaching default, pressure on management mounts from shareholders requesting a turnaround (Chang, Dai, Durand & Koh, 2015). Chang et al stated that corrective measures may be demanded by creditors in cases where debt covenants are likely to be dishonoured. The need for restructuring increases as companies are susceptible to illiquidity during the progressive stages of financial distress; otherwise they will be forced to file for bankruptcy (Hoberg et.al., 2016). The objective of *IAS 37* is to ensure that management disclose adequate information in the notes to enable users to have an understanding of the nature, timing and amount of contingent assets, contingent liabilities and provisions.

IAS 37, paragraph 10, states that "A restructuring is a programme that is planned and controlled by management, and materially changes either: (a) the scope of a business undertaken by an entity; or (b) the manner in which that business is conducted". *IAS 37*, paragraph 73, states that evidence should be provided if the company is in the process of implementing a restructuring plan, for example, a company may announce to the public the main features of the plan or selling assets. A constructive obligation arises as a result of the public announcement only if it is made in adequate detail such

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that it generates valid expectations in other parties, such as customers, employees and suppliers, that the entity will carry out the restructuring.

During the restructuring process, an entity may discontinue some operations or put aside certain assets than can be sold. This triggers *IFRS 5, Non-current Assets Held for Sale and Discontinued Operations*. The IFRS objective is to stipulate the accounting for assets held for sale, and the presentation and disclosure of discontinued operations. According to *IFRS 5*, paragraph 30, the entities should disclose and present information that enable users of the financial statements to evaluate the financial impact of discontinued operations and disposals of non-current assets. Hoberg et al. (2016) stated that, in order to ensure liquidity, a company has to convert assets into cash to avoid bankruptcy. Bokyung (2018) agreed that a financially distressed company is commonly relieved from bankruptcy risk by selling its assets, though it is a problem selling specialised ones.

IAS 36, *Impairment of Non-financial Assets,* comes into play when the non-financial assets turn out to be impaired due to insufficient funds to ensure productivity. IAS 36 paragraph 1 states that ''The objective of this Standard is to prescribe the procedures that an entity applies to ensure that its assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and the Standard requires the entity to recognise an impairment loss. The Standard also specifies when an entity should reverse an impairment loss, and prescribes disclosures”. When there are recurrent material losses, going concern assumption may not be appropriate.

2.3.1.2 Disclosures

The results of disposing of assets and discontinuing operations, as well as impairment of both financial and non-financial assets, has an effect on the solvency and liquidity of the entity. Thus, an assessment of the liquidity and solvency position of the entity can be made by perusing *IFRS 7*. According to Coetsee et al. (2012), companies are mandated to provide disclosures in accordance with *IFRS 7* that can be evaluated by users when evaluating the significance of financial instruments and risks, such as credit risk and liquidity risk, arising from those financial instruments to which the entity is exposed at the end of the financial year.

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Coetsee et al. (2012) indicated that the disclosures required by *IFRS* 7 consists of qualitative and quantitative disclosures. Qualitative disclosures arise from internal information provided to management and are a summary quantitative data about the entity exposure to risk (Coetsee et al., 2012). When providing qualitative disclosures entities are required to discuss about how the risks came about, the exposure to those risks and ways of managing and methods applied of measuring the risks (Coetsee et al., 2012).

To ensure comparability, *IFRS* 7 provides prescribed minimum disclosure results that users may consider when comparing risk exposures across different entities. The *IFRS* 7 disclosures stem from the requirements of *IFRS* 9. *IFRS* 9, paragraph 1.1 states that ''The objective of this Standard is to establish principles for the financial reporting of *financial assets and financial liabilities* that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity's future cash flows".

There are events that occur after the reporting period that may create a challenge to the existing financials. The accounting for such events is covered in *IAS 10*. *IAS* 10, paragraph 1 states that "The objective of this Standard is to prescribe: (a) when an entity should adjust its financial statements for events after the reporting period; and (b) the disclosures that an entity should make about the date when the financial statements were authorised for issue and about events after the reporting period. *The Standard* also requires that an entity should not prepare its financial statements on a going concern basis if events after the reporting period indicate that the going concern assumption is not appropriate". Going concern assumption may not be appropriate where there is an indication of an event after balance sheet event that raise doubt about the company's ability to continue in existence.

Lentner and Zéman (2018) indicated that, when the economy is booming, management decisions are aligned to going concern assumptions, but the connection is soft. Contrarily, during a recession, management decisions are not aligned to going concern assumptions, yet going concern assumptions have a strong impact on management decisions (Lentner & Zéman, 2018).

A concept raised by Carson et al. (2011) is that, as time progresses, going concern disclosures start becoming more accurate, but the accuracy is less than half.

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Bochkay, Chychyla, Sankaraguruswamy and Willenborg (2018) studied the elements relating to voluntary management disclosures about going concern uncertainties and their information content. They found that going concern disclosures are negatively linked with financial incentives yet positively linked with the extent of risk disclosures. They said the disclosures pertaining to the going concern assessment are affected by risk and agency motivation.

The users of financial statements consider the going concern assumption to be key when assessing the performance of an entity (Lentner & Zéman, 2018). They indicated that the users include creditors when deciding to provide credit or commercial loans, or rating an agency for solvency.

The JSE (2018) noted matters relating to going concerns as follows:

> *There was insufficient and conflicting disclosure of the facts and circumstances that led to the conclusion that the entity was still a going concern. This was contrary to* IAS 1 *par 25 which calls for the disclosure of any uncertainties regarding the going concern assessment (JSE 2011: Matter 2).*
>
> *There were several instances of insufficient disclosure for significant judgements and estimation uncertainty including: …the appropriateness of the going concern assumption (JSE 2013: Matter 4).*
>
> *The disclosures provided by an issuer related mainly to the rectifications that were in place and did not also deal with the material uncertainties (in this instance why the entity was loss making and in a position where its liabilities exceeded its assets). A useful test that issuers could therefore consider is does the disclosure sufficiently answer the question of 'what went wrong'? (JSE 2018: Matter 1).*

In its report, the JSE (2018) noted that, in July 2010, an update which the International Financial Reporting Interpretations Committee (IFRIC) provided stated that, a disclosure is useful if it provides a true going concern status. The JSE mentioned the activities of the Financial Reporting Investigation Panel (FRIP) in 2015 regarding the application of the going concern basis of accounting where there is an impending business rescue. The FRIP referred to an explicit matter where the issuer suffered financial difficulties that led to many material uncertainties relating to future contracts, conversion of preference shares to equity ability and other matters. The issuer

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disclosed some of these uncertainties in 2013 provisional results, annual financial statements (AFSs), and in 2014 interim results; however, the FRIP noted that the issuer started the proceedings pertaining to the business rescue in December 2013. This led to the JSE's raising questions on how entities apply *IAS* 1 about going concern in their different annual reports.

The JSE reported that the FRIP pointed out that the *IFRSs* provided no definition of the terms *material uncertainties* and *going concern*, nor did it provide guidance the exercise of judgement in going concern assessment. The JSE warned that it is only management that makes the decision to assume going concern status and that high degree of judgement is required in that regard. The JSE indicated that the FRIP did not provide conclusions on going concern assessments, although disclosure should provide judgements on uncertainties and assumptions applied. The FRIP did note that the said disclosures were not provided by issuers.

The JSE repeated the FRIP revelation that issuers fragment their information, posing a challenge for users to appreciate the full picture of the status of the entity and its material uncertainties. The FRIP did not provide further recommendations because the entity delisted from the JSE; however, the FRIP advised the JSE to issue guidance to listed entities, so that they provide disclosures on material uncertainties, assumptions and judgements relating to going concern in one location headed "going concern''. As the JSE indicated, the FRIP suggested that management should ensure that users are directed to such disclosures when there is a close call, in the event of a business rescue, when there is material uncertainty, and technical liquidity or solvency.

2.3.2 Going concern opinions

According to Venuti (2004), it is the mandate of auditors to audit the going concern assessments made by a company and issue an audit report. The audit report equips auditors to inform users about problems faced by the company, including the company's going concern status (Lopez-Corrales et.al., 2017).

According to Keglevic, Tanja and Zelika (2019), judgements are expressed by auditors when they give conclusions about whether an entity is a going concern or not. Keglevic et.al. (2019) indicated that models are used by auditors to form the basis of their opinion. They investigated the analytical procedures used by auditors to assess going

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concern position with the aim of measuring the efficiency of Altman's and Zmijewski's models. They performed the study on financially unstable companies operating at a loss, those that were assessed as going concerns and those that were not. The conclusion they reached was that, had the auditors used the Altman's and Zmijewski's models, they would have arrived at the same conclusions. They said the models can be used to classify companies and assess going concern.

Callaway, Daugherty, Dickins and Higgs (2016) studied how the wording pertaining to the going concern paragraphs as stated in the standards affected the manner in which auditor's tests were extended, which ultimately impacted the audit opinion. They concluded that the way in which the going concern is worded produced different audit conclusions. There is therefore a need to harmonise the accounting standards.

Goh, Krishnan and Li (2011) stated that the presence of weak controls intensifies the challenges auditors face in determining whether a company is a going concern. The act of issuing a material weakness opinion engenders conservatism in issuing the going concern opinion. Further aspects that affect the reliability of going concern opinions are the rapid changes in technology, the complexity thereof, and the volume of transactions to be processed (Eickemeyer & Love, 2016).

Christensen, Neuman and Rice (2019) studied how information gets lost in audit reports. They indicated that signals in the reports issued by auditors do not communicate residual risks that are likely to continue in future because of audit report lags and huge audit fees. The signal of improvement in internal controls is likely to result in companies' being restated in future. They further indicated that companies with no doubts about continuing as a going concern may declare bankruptcy in future.

Berglund, Eshleman and Guo (2018) asserted that auditing theory envisages that Big Four firms have a higher chance of issuing a going concern opinion to a distressed company than medium-sized firm. Berglund et.al. (2018) indicated that Big Four firms are very conservative and more accurate than medium firms after considering client characteristics. They added, however, most companies audited by the Big Four firms fail dismally in future. After concerns were raised about the fact that a poor-quality audit resulted in a financial crisis, Kanyarat (2018) studied the accuracy of going concern modifications. Kanyarat (2018) concluded, contrary to Berglund et.al. (2018), that non-Big Four auditors were more conservative about clients' going concern problems than

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Big Four auditors. This suggests that the size of the auditing company affects its going concern opinion.

Hu and Sathye (2015) revealed that, in arriving at their judgement, auditors usually consider macroeconomic conditions and non-financial information, not restricting their considerations to financial data. The existing financial crisis is making it difficult for firms to remain in operation, and this has created an interest in audit reports issued (Lopez-Corrales et.al., 2017).

Chytis, Filos and Gkouma (2018) stated that companies undergoing financial distress are usually reluctant to disclose their true going concern status, and end up being issued a modified audit report. They asserted that disclosing the true company's going concern status results in a reduction in the sources of funds available, an increase in the collateral required to secure debts, a reduction in creditors' credit periods, and flight by key employees to look for greener pastures. They added that these adverse results actually lead to the company's failure, indicating that an audit report with an emphasis of matter or qualification is a "self-fulfilling prophecy".

In the South African context, entities that were issued with an emphasis of matter or qualification on their going concern status and later collapsed include African Bank and Basil Read.

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Lopez-Corrales et.al. (2017) indicated that, as the financial crisis increased, the amount of Spanish audit reports that recorded modified going concern opinions also increased, first with more qualification paragraphs and then with more emphasis paragraphs. This was due to adopting the international standards to afford a basis for comparisons between audit reports in the international community.

Many studies have been undertaken on what affects the issuance of going concern opinions. Hendarjatno and Simamora (2019) discovered that audit client tenure, audit lag and liquidity ratio did not affect the going concern audit opinion, whereas pinion shopping and leverage did affect it.

Dao, Wu and Xu (2018) conducted a study of the impact of manipulations on sales overproduction and reduction of discretionary expenses regarding the auditors' judgment to issue going concern opinions for distressed companies. They discovered that going concern opinion and the manipulations have a positive and significant

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relationship in a financially distressed company. They indicated that auditor conservatism is affected by the company's unusual business activities.

Omer, Sharp and Wang (2018) explored the link between the issuing going concern qualifications and the religiosity of audit firms. They discovered that, because of increased professional scepticism in assessing mitigating factors, religious audit firms issued more qualified going concern opinions.

Brown, Fischer and Marsh (2016) indicated that there is great informative value created for investors and analysts regarding the going concern disclosures. They indicated that disclosures provided in the financial statements affirm the entity's continuity. O'Reilly (2009) revealed that investors have a perception that the going concern opinion has useful information. O'Reilly indicated that the judgements made by auditors on whether the entity is viable are valued by investors.

Studies were undertaken relating to the reaction of users to an audit opinion with going concern modifications. Generally, users of financial information become uneasy when there is a going concern disclosure or opinion (Brown et.al., 2016).

Geiger and Kumas (2018) investigated whether investors anticipated the receipt of a modified opinion by a distressed firm and whether they reacted by selling shares. They concluded that the auditor's modified opinion has an impact in the marketplace as investors do sell shares.

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Dong, Robinson and Robinson (2015) indicated that there was a decrease in the earnings of companies for which modifications were issued unexpectedly.

2.4 FINANCIAL DISTRESS AND DISCLOSURES

2.4.1 Background on financial distress

In any economy, companies that discharge financial information can be either non-distressed or distressed (Khurshid, 2013). Financial distress is caused by many elements, including the costs of debt, equity and capital, economic conditions, leverage and the volatility of earnings. Thus, insolvency can lead to loss of capital, revenue and credit. A company in the course of becoming insolvent is suffering "death by inches". Companies are unable to deal with their issues the right way though they are well

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versed with their problems. (Khurshid, 2013). These elements are key to evaluating the company's financial situation.

Hu and Sathye (2015) stated that, when a company is financially distressed, financial sustainability is usually threatened. They cautioned that it is of utter most importance for the company to have mechanisms in place that enable it to sense corporate financial distress so that financial sustainability can be promoted.

The financial distress of companies has an impact on various investors and on society at large (Khurshid, 2013). While non-distressed companies continue to grow speedily, the financially distressed firms file for bankruptcy and vanish from the stock exchange (Khurshid, 2013). In a South African context, the Companies and Intellectual Property Commission (CIPC) provides a statistical summary of the status of business rescue proceedings within the country based on company registrations (CIPC, 2019). The CIPC reveals the number of business rescue proceedings commenced for each of the classified industries, as shown in Table 2.2 below:

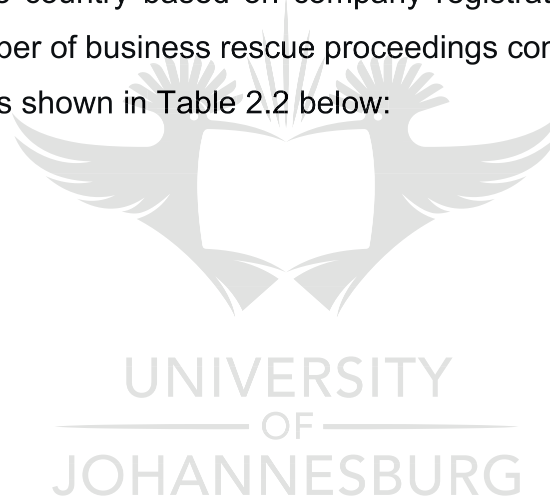

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Table 2.2: Business rescue proceedings started per industry

Industry	Total	2014-2015	2015-2016	2016-2017	2017-2018	2018-2019	2019-2020
Accommodation and food service activities	63	4	1	17	22	16	3
Administration and support service activities	71	18	25	12	5	11	
Agriculture, forestry and fishing	92	6	23	25	16	17	5
Arts, entertainment and recreation	15	2	4	4	3	2	
Construction	230	35	65	39	42	34	15
Education	13	2	2	5	1	3	
Electricity, gas, steam and air conditioning supply	25		6	2	2	15	
Financial and insurance activities	91	24	20	16	17	13	1
Human Health and Social Work	18	1	3	2	9	3	
Information and Communication	47	10	13	8	5	8	3
Manufacturing	205	28	43	34	41	46	13
Mining	113	28	25	11	36	12	1
Not provided	256	141	36	34	23	14	8
Other Activities	59	9	8	11	3	27	1
Professional, scientific and technical activities	94	13	26	18	23	12	2
Public administration and defence; compulsory social security	7		5	1	1		
Real Estate Activities	180	26	33	34	35	44	8
Transportation and storage	111	21	25	18	14	29	4
Water supply, sewerage, waste management and remediation activities	12		4	2	4	2	
Wholesale and Retail	365	45	114	82	60	41	23
Grand Total	**2067**	**413**	**481**	**375**	**362**	**349**	**87**

Source: Extracted from the CIPC website, (CIPC, 2019) p. 12.

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2.4.2 The concept of and the need for financial disclosures

In an attempt to warrant that the company's financial statements remain comparable with financial statements from prior periods, and of other companies, *IAS 1* set outs common standards that can be used to present information in the financial statements. Lopez, Monelos and Sanchez (2013) stated that the *IFRSs* details the format in which the financial statements should be presented as well as the content thereof. They further indicated that IFRSs specifies assets of each standard and how those assets should be valued to warranty the quality of accounting information.

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In terms of disclosures, *IAS 1* states that notes have additional information apart from the elements presented in the financial statements. The standard further states that these notes provides a description of items presented in those statements, and information about items that did not meet the recognition criteria in those statements.

IAS 1, paragraph 77, states that information can be presented either in the statement of financial position or in the notes, and further sub-classification of the line items presented, should be done in a manner appropriate to the entity's operations. *IAS 1*, paragraph 112, indicates that notes should explain the basis upon which the financial statements are prepared, and the specific accounting policies applied. Further, it states that notes are there to disclose the information required by the *IFRSs* that is not presented elsewhere in the financial statements but is relevant to an understanding of any of the information included in the financial statements. *IAS 1*, paragraph 113, requires an entity to present the notes in a procedural way, as long as it is practicable.

IAS 1 requires consideration of the comparability and understandability of the financial statements. This necessitates cross-referencing of information presented to any related information in the notes. The cross-referencing is achieved by disaggregating information in the segments, groups and subgroups in the components of the financial statements consistently.

The IASB (2017) indicated in the Disclosure Initiative that it takes more time to analyse financial information that is not communicated effectively, which can result in overlooking relevant information. The following were therefore considered as ineffective communication by the IASB (2017):

- generic or boilerplate statements, for example, stating what the accounting standard state;
- unclear descriptions, for example, providing one word describing the nature of a transaction;
- poor organisation of information, for example, not following a proper structure in disclosing information;
- unclear linkage;
- unnecessary duplication, for example, disclosing the same information throughout the financial statements;

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- needlessly changing information industry practice or overtime;
- too many narratives, whereas using a table might be suitable; and
- including information that is not material or not including material information.

The IASB (2017)'s initial view was that entities should apply developed guidelines of effective communication when preparing the financial statements. The following were considered effective communication:

- entity-specific instead of just per disclosure standard;
- simple and direct narrative;
- highlighting important matters;
- linkage (see below on cohesiveness);
- no unnecessary duplication;
- optimum comparability without compromising usefulness; and
- suitable formatting for the category of information.

The IASB (2017) indicated that entities had noted that users tend to analyse information pertaining to the components of the financial statements as opposed to the notes. This distorts understandability of the full picture of the financial statements.

Regarding the disclosure pertaining to the accounting policies, *IAS 1*, paragraph 119, states that accounting policies assist users in interpreting ways wherein transactions and events unfolded, as shown in the elements of financial statements. Therefore, *IAS 1* intends that management should consider the nature of operations, as well as the policies users expect to be disclosed in the financial statements.

These disclosures are very useful to users, especially when the *IFRSs* have alternatives to select from. As stated in 2.3.1, paragraphs 122 to 125 of *IAS 1* requires disclosure of judgements, including those involving estimates, that may cause the carrying amounts of assets and liabilities to be materially adjusted within the next financial year.

The IASB (2017) raised a concern in its Discussion paper that the section in financial statements where accounting policies are situated has been considered long and obstructive as: (a) there is no clarity about which accounting policies would make users understand financial statements; (b) various disclosures are not distinguished; and (c)

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accounting policies are not entity-specific, creating problems for users to identify the important policies. In addition to the above, the IASB (2017) noted that *IFRS* requirements do not provide a lot of guidance on: (a) accounting policies that are significant, (b) which information is to be disclosed about those significant accounting policies; and (c) where those disclosures ought to be located in the financial statements.

According to the IASB (2017), extra requirements ought to be specified in a general disclosure standard in order to assist entities to make decisions on which accounting policies to disclose. If accounting policies are considered significant, they should be disclosed to achieve understandability which enhances the information in the financial statements (IASB, 2017). The three categories of accounting policies identified by the IASB (2017) are: 1–necessary and relate to material items, 2–material amounts and nature, and 3–other. The IASB (2017) explained that categories 1 and 2 are required for understandability, and category 3 is not a requirement. The IASB (2017) advised that accounting policies in category 3 should be problematic by making the financial statements extra difficult to understand or obscure material information.

According to the IASB (2017), disclosures about significant assumptions and judgements should be clearly highlighted. The IASB (2017) indicated that the difficulty faced by preparers in applying judgement on what information to disclose seemed to have triggered the disclosure problem. This inability to apply proper judgement has been attributed to the lack of direction pertaining to the structure as well as content of the financial statements (FSs), predominantly about disclosures in the notes (IASB, 2017). Accounting standards have unclear disclosure objectives and their disclosure requirements are perceived to be merely compliance issues(IASB, 2017). Entities tend to make disclosures as per the standard rather than entity-specific ones(IASB, 2017).

The IASB (2017) noticed the difficulty that companies face regarding decisions on the information that needs to be disclosed about significant policies. The IASB (2017) pointed out that the difficulty is caused by the struggle to apply the concept of materiality, in response to which the IASB (2017) has developed a practice statement that provides direction on materiality. The IASB (2017)'s interpretation was to have a general disclosure standard that clarifies the requirement for disclosures to be entity-

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specific. The IASB (2017) 's initial opinion was that it was unnecessary to provide further guidance on making accounting policy disclosures entity-specific.

The IASB (2017) Disclosure Initiative aimed to deal with the discrepancies in applying the disclosure requirements and advise on the effective communication of financial disclosures to make users aware of the disclosures. An overload of financial disclosures exposes investors to risk when the disclosures are not relevant (IASB, 2017). The IASB (2017), however, indicated in the Disclosure Initiative that the objective of financial reporting is too general for entities to determine what is useful to users. Further, the IASB (2017) noted that some accounting standards do not have a disclosure objective and that, where disclosure objectives are present, such disclosures are isolated from the main objective of financial reporting (Burk, Gong & Hung, 2015).

In that regard, the IASB (2017) considered developing a centralised disclosure objective or a standard covering all disclosures. The IASB (2017)'s initial opinion is that centralised disclosure objectives should be included in a general disclosure standard making them authoritative and more visible. The IASB (2017)'s further opinion is that, when there are no disclosure objectives in a specific standard, an entity can resort to the centralised disclosures. Centralisation of disclosure objectives was also viewed by the IASB as a way to provide assistance to the companies in identifying extra information that could be included in the financial statements to comply with the *IFRSs* (IASB, 2017).

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2.4.3 Existing literature on financial disclosures

Financial disclosure occurs when a company releases all relevant information regarding its financial status, which enables investors to make appropriate financial and economic decisions, thus achieving the objective of financial reporting (Albawwat & Yazis Ali basah, 2015; Georgakopoulos, Popova, Sotiropoulos & Vasileiou, 2013; Segal, 2018). Kamaluddin, Kazemian, Sanusi, Shauri, and Shuhidan (2017) indicated that the company's key priority is to make sure investors have knowledge of what the company earns (bottom line) and how much they will receive from the earnings. Investors then base their hold, sell or buy investment decisions on the disclosed information; however, if such information appears unreliable, investors consider it irrelevant in decision-making, so it has no influence on share prices or investor

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behaviour (Rahman, 2012). An investor has the right of to obtain accurate information in a timely manner because, when an entity fails, investors are the last to receive their share of distributions, after creditors – that is, if anything remains (Cohen & Webb, 2007).

Financial disclosures are receiving substantial attention from both preparers of financial statements and users of financial statements due to their increasing complexity. (Ernst & Young, 2014). One evidence of deficiency in accounting practice since the corporate scandals seen over the past several decades, from Enron to WorldCom, is the level and use of financial disclosures (Zucchi, 2018). A view has been put forward that current disclosure practices are ineffective in drawing users' attention to the most decision-useful information (Ernst & Young, 2014).

Companies have ingeniously hidden the affairs of the company in their lengthy financial reports, leading investors to mistrust management intensely and to be afraid of the unknown (Zucchi, 2018). Loughran and McDonald (2013) stated that investors tend to invest in companies with financial disclosures that are not hidden in obscure language and legal jargon, and can be easily assessed.

In order for financial disclosures to be effective, it is imperative for users to be able to access the information, have the capacity to interpret it, and be willing to incorporate it in their decision-making process (Burke, Gong & Hung, 2015). Coetsee et al. (2012) affirmed that businesses need to go beyond the old way of presenting financial reports, where only quantified financial information was given. They indicated that there is a need for more non-financial information.

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2.4.4 Elements of financial disclosures

2.4.4.1 Voluntary and involuntary disclosures

Financial disclosure in financial reporting can be mandatory, non-mandatory or voluntary (Albawwat & Yazis Ali basah, 2015). Georgakopoulos et al. (2013) indicated that mandatory disclosure occurs when companies disclose specific features of information imposed on them by regulatory authorities, whereas voluntary disclosure occurs when companies make their own decisions to disclose additional information that they deem will benefit them. They further state that regulatory bodies like the IASB stipulates mandatory disclosures, while managers provides voluntary disclosure.

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Public listed companies are mandated to communicate information to users, particularly investors and analysts, through disclosures so that those users may have a full picture of their financial affairs (Loughran & Mcdonald, 2014). Some organisations with good management positions voluntarily disclose more financial information than is required by law (Beattie, 2018). Gantyoweti and Nungureni (2014) indicated that there is limited research that studied the impact of financial distress position on the level of voluntary disclosure, and the results still vary.

Voluntary disclosure is typically aimed at providing a clear perspective to the valued stakeholders about the company's prospect of long-term sustainability. Additionally, it aims at reducing agency conflicts between the directors and particular investors as well as information asymmetry. In this regard, businesses have become increasingly aware of the fundamental importance of presenting information about their activities to the stakeholders. Some of the information is availed by a company's annual reports or other publications. In this regard, companies disclose as much information as is possible. This is crucial, as organisations with perfect corporate governance can raise capital from the markets at a relatively lower price. Moreover, the more open the disclosure, the greater the extent to which the stock prices reflect the whole truth, further obeying the fundamentals of the market. This significantly helps the investors when choosing which securities to invest in (Barako, Hancock & Izan, 2015).

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Voluntary disclosure refers to the provision of information by a company's management beyond the requirements that are accepted by accounting principles. It is an activity specifically carried out by many companies. However, the extent and type of voluntary disclosure differ according to the industry, geographic region and company size. The field of voluntary disclosure has been identified for potential research in accounting.

The Financial Accounting Standards Board (FASB, 2001) categorise voluntary disclosure into five classes. First, there is business data that entails a breakdown of market share growth and information on new products. Second, there is the analysis of the business data, which includes trend comparison and analysis of what the competitors are offering. Thirdly, forward-looking information notifies users about sales forecasts and plans for expansion. The fourth class of voluntary disclosure consists of fundamental information about the shareholders and management, including

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information about creditors and stockholders, as well as the shareholding breakdown. Fifth is information about the company's background, long-term objectives, products and intangible assets, such as development and research about customer relations.

It should be noted that the major aim of voluntary disclosures is to inform the general public about the company. Besides, the management hopes that the stakeholders will respond positively to the company by either buying more shares or seeking affiliation. Notably, financial, strategic or non-financial voluntary disclosures suggest that some organisations gain immense benefits by disclosing more than is expected, if the information is availed strategically to the shareholders (Nelson, 2009) to increase the market expansion strategies of the manufacturing industry (Asava, 2013).

2.4.4.2 Good and bad news disclosure practices

Mandated or voluntary financial disclosures can be good or bad news, depending on the incentives motivating managers to disclose such information (Kumar, Langberg & Sivaramakrishnan, 2012). Managers are motivated by incentives that are both long-term and short-term, and they tend to balance their disclosure of good and bad news to be a competitive advantage for the organisation (Kumar et al., 2012). These authors claimed that there can be a balance between two desirable but incompatible features. Albawwat and Yazis Ali basah (2015) stated that, in the present economy, entities endeavours to publicise their good value in form of disclosures as a way of convincing their investors that investment in them is beneficial to them.

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2.4.4.3 Level of disclosures

Albawwat and Yazis Ali basah (2015) said the way at which the level of information is released in the final annual financial statements reports is vital to creditors as well as investors as they scrutinise this information when making decisions. Lai, Liu and Wang (2014) suggested that there is a positive association between high financial disclosure levels and the ability to make effective decisions when evaluating the company's value. They indicated as disclosure levels increase, investors may be able to determine the return on investment opportunities and monitor the utilisation of their injected capital, once committed.

Huang and Zhang (2012) stated that intensified disclosures improve investor oversight and discipline; that is, spot the reduction in value or destruction resulting from inefficient

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allocation and waste of corporate resources. Lai et al. (2014) indicated that increased disclosure levels mitigate both over- and underinvestment problems. Broadly, their findings proposed that, when the disclosure levels are increased, it has an impact on the investment decisions made internally, at the same time making the information accessible to the investors.

As earlier noted, information asymmetry and agency conflict usually impede the allocation of resources in the economy of capital markets. Financial studies reveal that most manufacturing companies are highly dependent on external financing and hence have a higher level of voluntary accounting disclosures. This further affirms the notion that manufacturing industries with a higher level of disclosure usually have lower costs of capital. In the light of this consideration, as voluntary disclosures substantially lessen information asymmetry, the cost of borrowing is also reduced (Barako et al., 2015).

2.5 CONCLUSION

Based on the literature review, there is still a gap between the auditing and accountants' standards on going concern disclosures. The *IFRSs* on uncertainties do not specify what needs to be disclosed and to what extent. The FASB took a bold step in attempting to harmonise the current accounting standards with the revised auditing standards. The literature review also indicated challenges faced by management in making going concern assessments and disclosures thereof.

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This has had an impact on auditors as they provide assurance on the adequacy of disclosures made by management on going concern. Having said that, there are also aspects that impacts the audit opinions, including audit tenure and the religion and performance of the entity.

Financial disclosures mainly communicate monetary information to the users of financial statements, and the users require this information to make informed investment decisions. It is therefore important to provide quality going concern disclosures and accurate, unbiased going concern opinions.

Companies that produce financial reports can be either financially distressed or non-distressed. Financial disclosure literature about financially distressed companies is relatively rare compared to literature about non-financially distressed companies.

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The following chapter discloses the methodology adapted in this study to conduct the research on the disclosure practices of financially distressed companies.

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CHAPTER 3. RESEARCH METHODOLOGY

3.1 INTRODUCTION

The objective of this study was to determine the year-on-year trend in the going concern disclosures of financially distressed companies that went into business rescue during the last three financial years (2017–2019).

This section discusses the methodology for the study. Techniques and tools are applied in gathering research data, which in turn is used to produce reports (Bickman & Rog, 2009). Research methodology encapsulates the techniques and tools used in order to prepare a research design (George, 2011). The research design consist of the following details; data sources, estimation approaches and models, population, and sampling techniques(George, 2011).

In order to conform with the definitions and draw from the research objectives, the section discusses the data source, data collection methods, population and sampling, data approach and analysis, ethical considerations and limitations of the study.

3.2 NATURE OF STUDY

3.2.1 Research design

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Punch (2011:62) asserted that "research design means all the issues involved in planning and executing a research project, from identifying the problem through to reporting and publishing the results".

3.2.2 Qualitative approach

A qualitative approach was applied, which entailed thematic content analysis of the financial disclosures in an effort to evaluate the trends in the going concern disclosures of companies with impending business rescue. Lewis et.al. (2012) defined qualitative research as an approach where relationships are studied using various means of collecting data, and an analytical review process that results in the development of a conceptual framework. A qualitative content analysis as an approach whereby patterns are systematically identified in the process of interpreting the content of the data in text format (Hsieh and Shannon, 2005).

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3.2.3 Interpretative paradigm

A paradigm is a method by which the world is understood and studied (Rehman & Alharthi, 2016). Lewis et.al. (2012) defined interpretivism as when the author understands disparities amid humans in our role as social sectors. This research was undertaken in the peripherals of the interpretative paradigm because its objective was to analyse the audited financial disclosures of the entities listed on the Johannesburg Stock Exchange and to provide an interpretation of the results.

3.3 POPULATION AND SAMPLE SELECTION

The objectives of this section are to discuss data collection and sampling approach in order to define the dependent and independent variables that were used in the study, to discuss the nominated statistical technique for developing the model, and lastly to discuss the data analysis.

3.3.1 Data collection

In any research, when testing the feasibility of a hypotheses, a topic is identified and data relating to that topic is collected and examined (Salkind, 2014). Data collection can be either primary or secondary in nature (Field, 2009). According to Creswell (2008), primary data is collected from first-hand sources using methods like interviews, questionnaires and surveys; and secondary data is collected by someone who is not the user. The study collected secondary data extracted from audited financial statements that had been published.

3.3.2 Population

The population comprised of all companies previously listed on the JSE that went into business rescue during the period from 1 January 2015 to 31 December 2019. The population consists of six companies (see Table 3.1) for which financial reports could be obtained from the companies' websites through an internet search. Because these companies were listed, their annual financial statements were subjected to statutory audits, so the data were considered reliable and valid.

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3.3.3 Sample selection

Any study is based on a population which consists of a total number of likely elements (George, 2011). The population is sampled so that the resulting sample only includes a portion of the population (George, 2011). Out of the sample, there can be sample frame which relates to the elements drawn from the sample (Blumberg et.al., 2014). The sample frame was specific that the firm should be listed and under business rescue.

According to George (2011), stratified sampling occurs when population is divided into separate groups or strata by the researcher, who then draw a probability sample from each group. In making a selection of the companies, a stratified random sampling method was used in this study.

At the initial stage, all companies that went on business rescue from 2015 were selected. Regarding the companies identified, an internet search was conducted to determine a group that could be used for the research. A company could only be analysed if it had a website, so this determined the population of companies that could be selected for the review process. Companies that were not previously listed on JSE were not included in the population and therefore eliminated. Six companies were identified and categorised per industry as follows: four construction, one retail, and one manufacturing companies. as noted in Table 3.1 below.

The subsequent process was to finalise a list of companies used for the empirical analysis through the application of an elimination process. Companies were eliminated if their financial reports were not available or not reviewed or if they went into business rescue before 2015 as ISA 570 on going concern opinions, was revised in 2015. In addition, financial reports that did not have sufficient information for review were not considered because their information was not fully comparable to that of other companies.

The elimination process as noted above produced a final sample of three companies in the construction industry. This represented 50% of all the companies that went through the elimination process, as articulated in Table 3.1 below.

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The construction industry has been hit significantly by the economic trading conditions. This has seen the listed companies belonging to the construction industry vanishing from the Johannesburg Stock Exchange.

Table 3.1: Companies under business rescue

No.	Company previously listed on JSE	Industry/Sector	Date of business rescue (SENS announcements/ website)	Financials available (Yes/No)
1	Basil Read	Construction	15 June 2018	Yes
2	Esor	Construction	2018	Yes
3	Group Five	Investment Holding Company/Construction	12 March 2019	Yes
4	Liviero Group	Construction	2018	No
5	Masonite Africa	Manufacturing/Timber	2016	No
6	Stuttafords	Retail	2016	No

Source: Own construction

3.3.4 Availability of data

Based on the availability of data, the sample comprised of three companies (see Table 3.1. The rest of the companies did not have financial statements because of liquidation, and some were under sanctions for failure to produce financial statements. An entity under business rescue is required by the Companies Act, no. 71 of 2008 to publish its financials but it is not always possible because of operational inadequacies. According to Lamprecht (2016), JSE listed entities are required to publish financial results based on the assumption that the businesses will be in existence for a lengthy time, and the *IFRSs* do not offer an alternative to the going concern assumption in cases of imminent liquidation.

Even though concessions allow certain elements to be measured at liquidation amounts, Lamprecht (2016) described them as presumptuous. Furthermore, an entity in business rescue is neither a going concern nor is it in liquidation, posing a problem in selecting the appropriate measurement criteria for valuing assets and liabilities (Lamprecht, 2016) Table 3.1 shows the companies that could not produce financials and those that could.

The method that has been applied in this study about the use of the percentage composition of companies is aligned with existing literature. For example, Ohlson's (1980) study comprised 5% failed companies, Åstebro and Winter (2012), 12%

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representation of failed companies, and Hernandez and Wilson (2013), 13% representation of failed companies. In that regard, the present study selected a sample of 50% of distressed companies, thus aligning with existing research.

3.4 TOOLS AND METHODS

The purpose of this dissertation is to study the disclosure practices of financially distressed companies, particularly their going concern disclosures.

3.4.1 Content analysis

The financial disclosures of the companies under review were put through content analysis in order to establish the year-on-year trend over three years of: 1) where the disclosures were located, 2) when the information disclosed was determined, and 3) the nature and extent of the information that was disclosed.

A “yes/no/not applicable” scale was used to determine where the disclosures were located. The similar approach was applied by Coetsee at al. (2012) so it was appropriate.

3.4.2 Quantification

The qualitative information was quantified in order to identify observable trends (Balgrie, 2014). Lopez-Corrales et.al. (2017) determined the year-on-year trend relating to the different opinions issued for the period 2007–2010 for Spanish companies. In order to draw their conclusions, they gathered and summarised reports that mentioned going concern matters constituting emphasis paragraphs or in qualification paragraphs. This enabled them to calculate a percentage in deriving a total sample. This approach was therefore acceptable for the current research.

The basis for studying the disclosure practices regarding the location of going concern disclosures was based on guidance raised by the IASB (2017) in the Disclosure Initiative pertaining to existing disclosures Further, the research considered requirements of Section 30(3) and Section 94(7) of the Companies Act regarding the preparation of auditor’s, director’ and audit committee reports.

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3.4.2.1 Coding

Over and above recording where the disclosures were available, and the timing of those disclosures, the disclosures were coded (Balgrie, 2014) to determine their nature and extent. The codification covered: (a) events and conditions disclosed; (b) an assessment of the significance of the events and conditions; (c) whether a detailed going concern assessment was performed, with detailed plans to mitigate the significant events and conditions identified; and (d) conclusions of whether a material uncertainty exists or not based on such assessment. Lopez-Corrales et.al. (2017), in determining year-on-year trends, found the main reason that caused going concern problems was the current financial crisis.

In South Africa, companies listed on JSE are required by the Companies Act of 2008 to adhere with the disclosures specified by the *IASs* in the *IFRSs* and to be audited in terms of the *ISAs (International Standards on Auditing)*. As such, the codes were derived from the disclosure checklist as per the approach used by Coetsee et al. (2012), and the *ISA 570* auditing guidelines.

IAS 1 in the *IFRSs* requires management to disclose information based on their assessment of going concern. *ISA 570* provides that auditors should formulate audit procedures that gives them assurance that the disclosures made by the entity are adequate. These include a review of the events and conditions, where management evaluated significance, where there were plans to mitigate, and where significant judgements were applied in the going concern assessment.

3.4.2.2 Quantum

The qualitative information must be quantified in order to identify observable trends (Balgrie, 2014). The next step was to determine the quantum of the going concern disclosures. This involved counting the number of going concern words in each of the locations identified above. An overall assessment of the going concern words was recorded in order to establish year-on-year changes in the disclosures. The basis for studying disclosure practices by quantifying going concern disclosures was based on guidance in the Disclosure Initiative.

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3.4.2.3 Quality

The next step was to analyse the compliance of disclosures with the *IFRSs*, based on an approach used by Balgrie (2014), which was adjusted where necessary to align with the *IFRSs* relating to financial disclosures. Over and above this, the overall quality of the disclosures was assessed for how well the information addressed the company issues, based on an analysis of the full set of financial statements.

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CHAPTER 4. FINDINGS

4.1 INTRODUCTION

This chapter outlines the findings relating to the trends identified in the going concern disclosures of three listed South African entities that went into business rescue. The findings from this study relied on the financial statements that were accessible on their websites. The trend analysis was more qualitative than quantitative as it focused on the companies' going concern disclosures in the published audited financial statements for the three years before business rescue.

Below is the detailed trend analysis of the disclosures relating to going concern in which certain notable trends were observed that seemed to warrant additional attention and analysis (Balgire, 2014).

4.2 LOCATION OF THE GOING CONCERN DISCLOSURES

The first step in this study was to determine where, in the financial statements, companies generally located their going concern disclosures, thus enabling a complete trend analysis.

Financial statements consist of the following statements and reports where disclosures to those financial statements are made: a directors' responsibility statement, an audit committee report, a directors' report, an explanation of significant accounting policies, including assumptions, estimates and judgements, including notes pertaining to the financial statements. Table 4.1 below indicates where the disclosures pertaining to going concern were made in the financial statements of the selected companies over the three years.

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Table 4.1: Location of going concern disclosures

	1st Year			2nd Year			3rd Year		
Disclosure Element	**Basil Read**	**Esor**	**Group Five**	**Basil Read**	**Esor**	**Group Five**	**Basil Read**	**Esor**	**Group Five**
Directors' Responsibility Statement	Yes	Yes	Yes	N/A	Yes	Yes	N/A	Yes	Yes
Audit Committee Report	Yes	No	No	Yes	No	No	Yes	Yes	Yes
Directors' Report	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Accounting policies, including significant judgements, estimates and notes to the financial statements	No	Yes	No	Yes	Yes	No	Yes	Yes	Yes
Totals	**3**	**3**	**2**	**3**	**3**	**2**	**3**	**4**	**4**

Source: own construction

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From Table 4.1 above, it can be seen that, in the first year, all companies made disclosure pertaining to going concern matters in the directors' responsibility statement and the directors' report. One company disclosed in the audit committee report and another made disclosures in the accounting policies including significant judgements, estimates and notes to the financial statements (the accounting policies section of the financial statements).

In the second year, matters relating to going concern were disclosed in the directors' report for all companies. One company made disclosures in the audit committee report and the other two in the directors' responsibility statement and the accounting policies section.

In the year of business rescue, going concern matters were disclosed in the audit committee report, directors' report and accounting policies section for all companies. two companies disclosed in the directors' responsibility statement.

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It is clear from Table 4.1 above that going concern disclosures were always included in the directors' report. However, there was a lack of consistency in the other areas where going concern disclosures were included. This meant there is deprivation to users in having the full picture of the going concern status.

4.2.1 Referencing

If the information is spread throughout the financial statements, the use of referencing is of utmost importance. It is necessary because the *IFRSs* do not have a going concern disclosure standard nor do they provide guidance on the location of going concern disclosures and the required content.

4.2.2 Overall assessment of the location of going concern disclosures

A quantitative assessment was performed to determine the overall trend in the location of going concern disclosures.

Table 4.2: Overall assessment of the location of going concern disclosures

Disclosure element	Yes	No
Directors' Responsibility Statement	78%	22%
Audit Committee Report	56%	44%
Directors' Report	100%	0%
Accounting policies, including significant judgements, estimates and notes to the financial statements	67%	33%

Source: Own construction

As noted from Table 4.2 above, of the three companies assessed, most of the going concern information was disclosed in the director's report, followed by the directors' responsibility statement, then the accounting policies section, and the audit committee report.

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4.3 TIMING OF GOING CONCERN ASSESSMENTS

This study examined the period for which going concern assessments were performed and the timing of the assessments, based on the information provided by the companies in various disclosures.

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Table 4.3: Timing of going concern assessments

Disclosure Element	**1ST Year**			**2ND Year**			**3RD Year**		
	Basil Read	**Esor**	**Group Five**	**Basil Read**	**Esor**	**Group Five**	**Basil Read**	**Esor**	**Group Five**
Directors' Responsibility Statement	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Audit Committee and Risk Report	N/A	N/A	N/A	12-month cash flow forecast	N/A	N/A	N/A	N/A	N/A
Directors Report	N/A	N/A	N/A	N/A	12-month cash flow forecast from date of Directors' Report	N/A	N/A	15-month cash flow forecast from date of Directors' Report	N/A
Accounting policies, including significant judgements, estimates and notes to the financial statements	N/A	N/A	N/A	N/A	12-month forecast cash flow from date of Director's Report	N/A	12-month cash flow forecasts	15-month cash flow forecasts from date of Audit Report	cash flow forecasts, 12 months from date of Financial Statements

Source: Own construction

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It can be determined from Table 4.3 above that, in all years, companies did not specify when the going concern assessments were performed. Sometimes, companies revealed the period for which the cash flow was forecast: Most companies performed 12-month cash flow forecasts. Only one company performed a 15-month cash flow forecast. This is consistent with the requirements of *IAS 1*. The *IAS* 1 standard does not indicate length of the time for which the assessment should be done.

The starting time of the cash flow forecasts were as of the date of the audit report, the date of the financial statements and the date of directors' report. These inconsistencies were because the *IFRSs* do not have a going concern disclosure standard that provides guidance on when the going concern assessments should commence.

4.4 NATURE AND EXTENT OF GOING CONCERN DISCLOSURES IN EACH LOCATION IDENTIFIED IN RELATION TO IAS 1 DISCLOSURE REQUIREMENTS AND ISA 570 AUDITING GUIDELINES

4.4.1 Analysis of the nature and extent of going concern disclosures

In order to analyse the disclosures pertaining to going concern, a code was allocated for each disclosure. The disclosures were then analysed to identify the contents and deficiencies of each. The codes allocated were as follows:

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GC 1: Events and conditions that cast doubt on the ability of the company to continue as a going concern.

GC2: Evaluation of the significance of the conditions and events.

GC3: Going concern assessment performed, including estimates, judgements and assumptions, with details of methods applied, as well as plans to mitigate the significant conditions and events, and to identify the impact of the conditions and events and mitigating plans on continuance as a going concern.

GC4: Conclusions of whether there is material uncertainty or not, based on the assessment performed.

Table 7 below reveals the results as per the coded areas.

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Table 4.4: Going concern disclosures

Disclosure elements	1st year	2nd year	3rd year
Basil Read has been in business rescue from 15 June 2018 to date			
Directors' Responsibility Statement	Directors disclosed the basis of the going concern assessment; that is, **GC3** cash flow forecasts and available cash resources.	No Directors Responsibility Statement	No Directors Responsibility Statement
Audit Committee Report	Audit Committee Report stated that the responsibility of the audit committee is to monitor and review solvency and liquidity position.	• Audit Committee Report mentioned the *IAS* requirements regarding assessments and judgements. • Mentioned management concluded going concern based on **GC3**: cash flow forecast and all available information. • Committee reviewed the cash flow forecast.	• Audit Committee Report mentioned the *IAS* requirements regarding assessments and judgements. • Committee mentioned management concluded going concern based on **GC3**: all available information, for example, debt standstill agreements. • Committee interrogated core assumptions in the **GC3**-cash flow forecasts. Referred to assessment. • The committee noted **GC1**: liquidity constraints. • The committee noted **GC3**:plans to mitigate liquidity constraints. Successful implementation will enable generation of cash flows. This result in obtaining sufficient liquidity.Cashflow will be impacted materially if plans are not successfully implemented. • Considerations of the findings reported by auditors on going concern,
Basil Read Directors' Report	Management mentioned **GC1**: liquidity constraints and **GC3**: actions to support liquidity, for example, resolve outstanding claims.	• Management concluded going concern status based on **GC3**: cash flow forecast, budgets and cash resources. • Reference to notes.	• Management considered **GC3**: going concern appropriateness. • Reference to assessments.

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Disclosure elements	1st year	2nd year	3rd year
Basil Read Accounting policies, including significant judgements, estimates and notes to the financial statements	No going concern disclosures	• Management disclosed **GC1**: liquidity constraints and future prospects. • Management also disclosed **GC3**: actions to support liquidity, for example, negotiate banking facilities, and possible debt issue	Management disclosed the following: • **GC1**: loss of key contracts and other, trading conditions. • **GC3**: IASs requirements on going concern assessment and judgments, • plans to mitigate **GC1**, for example, debt agreements, budgets and 12 months cash flow forecast, including key assumptions, such as accelerating claims by marking progress, negotiating extensions with funders based on successful agreements concluded. • in the significant judgement or notes, mentioned **GC4**: plans will improve liquidity; if not concluded successfully, cash resources impacted materially. Going concern with material uncertainty,for example, negotiations depended on agreements and prolonged period for significant assets.
Esor has been in business rescue from 2018 to date			
Directors' Responsibility Statement	No going concern disclosures	• Directors disclosed **GC1**: cashflows impacted by losses and impairments on unresolved long-outstanding claims • Reference to Directors' Report: • Directors indicated **GC3**: cash flow scenarios stress-tested, subjected to internal and external processes. Considerations included information at hand; evaluated the likelihood of future cash flows considering the current construction industry. • Directors concluded on **GC4**: Material uncertainty: Timing and quantum of several cash inflows;	• Directors disclosed **GC1**: cashflows impacted by losses and impairments on unresolved long-outstanding claims. • Reference to Directors' Report: • Directors indicated **GC3**: cash flow scenarios stress-tested, subjected to internal and external processes. Considerations included information at hand; evaluated the likelihood of future cash flows, considering the current construction industry. • Directors concluded on **GC4**: Material uncertainty: Timing and quantum of several cash inflows. Impact: material effect on the ability to pay creditors as they fall due.

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Disclosure elements	1st year	2nd year	3rd year
		impact - material effect on the ability to pay creditors as they fall due.	
Audit Committee Report	No going concern disclosures	No going concern disclosures	• Audit committee noted **GC1**: liquidity constraints. • The committee stated the requirements of *IAS* for assessments and judgements. • The committee indicated that **GC3**: management used available information and timing of inflows, for example, sales, claims, insurance proceeds and short- and long-term cashflows. • Committee interrogated the core assumptions in determining cash flow forecasts. • Reference to note where the assessment was performed. • Reviewed plans to mitigate the liquidity position. • To confirm robustness of the cash flow forecast: performed sensitivity and what-if analysis to cash flows in stress testing assumptions and timing of inflows. • **GC4**: committee concluded that the successful implementation of plans would allow enough cash to be raised. If cash flow analysis not concluded successfully, would impact cash flow resources materially.
Esor Directors' Report	Directors disclosed **GC3**: thorough process based on management's plan for future action was undertaken and the ability to raise funds, therefore going concern applicable.	• Directors mentioned **GC3**: a thorough process, and **GC1**: losses which included onerous provisions. • The company mentioned **GC3**: stress-tested 12-month cash flow date of directors report, future cash flows: losses, available facilities, for example, overdrafts, trade finance.	• Directors mentioned **GC3**: a thorough process, and **GC1**: losses which included onerous provisions. • Directors mentioned **GC3**: 15-month cash flow forecast; detailed plans to improve cash flows sustainability: finalise contracts, dispose of idle and core assets, refinance equipment through vendor finance, provide adequacy security to bankers, ongoing communication with guarantor providers to maintain adequate bonding facilities.

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Disclosure elements	1st year	2nd year	3rd year
		• Probability of order book, pending awards, and timing of insurance claims received, as a basis for going concern.	• Assumptions on the timing of major inflows detailed: date expected to receive and quantum estimated. • **GC4**: directors concluded, if not realised, cash flow materially impacted. Material uncertainty on the timing and quantum of the cash inflows.
Esor Accounting policies, including significant judgements, estimates and notes to the financial statements	• Management disclosed under risk management note that **GC1**: it is not leveraged. • **GC3**: thorugh going concern assessment and avalaibility of facility that may used to take advantage of settlement discounts • Basis of going assessment and ability to raise finance, despite the losses.	• Management disclosed under risk management note that **GC1**: losses recognised included the onerous contract provisions. • In considering the future considered **GC3**: cash flow forecasts 12 months from date of directors report and losses included in the provision included in the forecasts.. • The cash flows in future for example; available facilities, profitability of secured order book and pending awards.. • Basis of going assessment and current available banking facilities and order book, despite the losses.	• Management disclosed under the notes to the financial statements **GC1**: loss and pressure on liquidity Included requirements per *IAS 1*. The company listed matters that place significant pressure on liquidity: losses on certain contracts, challenging economic conditions in the industry awards of contract and delays in payments, inability to obtain short- to medium-term funding. • **GC3** strategies: expedite completion of loss-making contracts and minimise losses; disposal of idle and non-core assets, refinancing of selected vehicles and equipment through vendor financing, resulting in a reduction in the overdraft facility (after balance sheet events). • Renegotiating payment terms with major suppliers and sub-contractors to more closely match the renegotiated outflows with the timing of anticipated future cash inflows. • Provision of security to primary bankers to cover facilities.
Esor Accounting policies, including significant judgements, estimates and notes to the financial statements continued.			• Ongoing support of guarantee providers to maintain adequate bonding facilities to facilitate the successful implementation of contract awards. Negotiations to dispose of certain development land. • Retrenchments renegotiate payment term.

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Disclosure elements	1st year	2nd year	3rd year
			• 15 months forecasted cash flows from date of the Audit Report. • Key assumptions: uncertain timing and quantum of claims and awards due, finalise insurance claims, customer ability to pay, pay creditors for renegotiated terms, disposal of idle and non-core plant and equipment. • **GC4**: directors concluded that cash resources would be materially impacted if projections not realised. • Included in the forecast the uncertainties regarding timing and size of the cash inflows.
Group Five has been in business rescue from 12 March 2018 to date			
Directors' Responsibility Statement	Directors disclosed their basis of the assessment, that is, **GC3** cash flow forecasts and available cash resources.	Directors disclosed their basis of the assessment, that is, **GC3** cash flow forecasts and available cash resources.	• Directors disclosed their basis of of the assessment, that is, **GC3** cash flow forecasts and available cash resources. • Reference to the assessment performed by directors.
Audit Committee Report	No going concern disclosures.	No going concern disclosures.	The committee mentioned **GC1**: loss-making contract, going concern and liquidity issues.
Directors' Report	Directors indicated **GC3**: there are adequate financial resources.	Directors indicated **GC3**: there are adequate financial resources.	• Directors indicated **GC3**: there are adequate financial resources. • Reference to going concern note on liquidity management and going concern assessments and assumptions.
Group Five Accounting policies, including significant judgements, estimates and notes to the financial statements	No going concern disclosures.	No going concern disclosures.	• Management disclosed under significant judgements, **GC1**: on solvency [current liability exceeds current assets] and liquidity position, trading conditions/loss on a key contract and losses due to: onerous contract charges, unmaterialised unsecured work, unsecured work materialising later than planned, retrenchment costs for a segment charged to earnings; impacts on liquidity and management thereof, for example,

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Disclosure elements	1st year	2nd year	3rd year
			unrecovered and rationalisation of overheads; decrease order book. • In evaluating the significance of the events, mentioned **GC2**: losses significantly impact results. The assumption was losses are significant events. Management mentioned the *IAS 1* requirements regarding going concern. • In assessing going concern, management of liquidity, management **GC3**: prepared budgets (next two years), liquidity models including cash flow forecasts (12 months from date of financial statements). • Management indicated it appointed independent external advisors and contract officers to review the budgets and contract assessments.
Group Five Accounting policies, including significant judgements, estimates and notes to the financial statements continued.			• Management monitored key contracts separately. • detailed initiatives developed, and regularly monitored. These included: descison to close business, retrechments. • Actions to generate cash in future includes:closing cliams; sale of property, plant and equipment. • Assumptions, estimates and judgements on the timing and size of key drivers of cash flows.
Group Five Accounting policies, including significant judgements, estimates and notes to the financial statements continued.			• Key assumptions included: taking contracts with 80% profitability, secure more contracts, reduce overheds; and disposal of investments. • bridge funding and loss making contracts. • To address the solvency and liquidity position, disposal of JV assets to settle the funding and improve liquidity.

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Disclosure elements	**1st year**	**2nd year**	**3rd year**
Group Five Accounting policies, including significant judgements, estimates and notes to the financial statements continued.			• **GC4**: material uncertainty on the timing of future cash flows • Management concluded on appriateness of going concern assessment based on the financial plans and forecasts, the actions taken and, information available

Source: Adapted from Basil Read, Esor and Group Five financial statements (JSE, Johannesburg Stock Exchange, 2019)

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The codes in Table 4.4 above indicate what was disclosed. A detailed assessment of the nature and extent of the going concern disclosures is provided below:

4.4.1.1 Directors' responsibility statements

There was some consistency in the information given in the directors' responsibility statements; however, there were also some inconsistencies. While some companies acknowledged the assessment, models applied, information considered and conclusions regarding material uncertainty, other companies merely mentioned that an assessment was performed.

Having the exact same information in different statements created an overload of information and incorrect use of referencing.

Companies in the same industry disclosed the same information, and that makes it questionable whether the information was entity-specific. It was only when the status quo changed because of financial distress that companies provided different information.

4.4.1.2 Audit committee reports

There was no consistency in what was included in the audit committee reports. In some cases, the audit committee provided detailed plans; in other cases, it detailed cash inflow; in still others, it specified the methods used to interrogate management's assessments.

Entities made reference to the notes detailing going concern assessments made by management. The audit committee reports provided more detailed information on these going concern assessments in the year of business rescue, and disclosed how the committee interrogated events and conditions, planned to mitigate events and conditions, made key assumptions in the preparation of cash flows, and considered their impact on whether or not there was material uncertainty.

Companies in the same industry draw exactly the same conclusion in their audit committee reports, which raises the question whether the information was entity-specific. It was only when the status quo changed because of financial distress that companies provided different information.

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4.4.1.3 Directors' reports

In the first year, one company disclosed events and conditions such as liquidity constraints, but did not mention how those conditions were evaluated; the company also disclosed detailed action plans to mitigate the events and conditions, for example, to resolve outstanding claims and negotiate banking facilities. Another company mentioned that a thorough process was followed as a basis for the going concern assessment, and accurate information was used, for example, about adequate cash resources. A third company only identified the information used, for example, adequate cash resources.

In the second year, all companies mentioned the information used for the going concern assessment; for example, adequate cash resources. Two companies mentioned the models used in the going concern assessment, for example, cash flow forecasts. Only one company mentioned events and conditions; however, it did not mention how those conditions were evaluated. One company provided a reference to estimates and judgements.

In the year of business rescue, in one company, directors mentioned that they considered whether the going concern assessment was appropriate and referred to the audit report and critical accounting estimates, assumptions and judgements. Another company provided detailed plans (for example, to dispose of assets), and specified the models used (for example, cash flow forecast) including the assumptions made about the timing of major inflows detailed (such as the expected receipt date and quantum estimate), before concluding that there was material uncertainty about the timing and quantum of the cash inflows. The third company mentioned the information used, for example, adequate cash resources, and referred to a going concern note on liquidity management, and going concern assessments and assumptions.

There were inconsistencies in the information disclosed in the directors' reports and in the extent of the information in different years and different companies. Sometimes companies indicated events and conditions, sometimes models used and sometimes the information used in assessing going concern.

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4.4.1.4 *Accounting policies including significant judgements, estimates and notes to the financial statements*

In the first year, two companies neither disclosed information pertaining to going concern in the significant judgements nor in the notes. The company that made a disclosure, disclosed the information in a risk management note about events and conditions. The company did not disclose how the significance of the events and conditions was determined. For the going concern assessment, it mentioned a thorough process based on future plans. Despite losses, the company was a going concern based on its ability to raise funds and the facility obtained to access settlement discounts.

In the second year, one company did not disclose any information pertaining to going concern either in the significant judgements or the notes. Two companies mentioned events and conditions, that is, liquidity and losses, without providing details; however, one of them mentioned actions to mitigate, for example, to resolve outstanding claims, while the other company mentioned models such as cash flow forecasts: The company revealed that onerous provision was included in the future cash flows; it included information that pointed to going concern status, like available facilities, overdrafts, trade finance, probity of the order book, pending awards, and the timing of insurance claims received.

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In the third year, in this section of the financial statements, one company mentioned conditions such as losses, the requirements of *IAS 1*, an approved turnaround plan for the sale of assets, negotiations with providers of capital, budgets and the cash flow forecast, and key assumptions made, for example, the sale of land and accelerated claims by marking progress. The company also mentioned successful actions; for example, disposal of assets and bridge funding. Management indicated successful implementation of the action plans would improve liquidity but, if they were not concluded successfully, cash resources would be impacted materially. Going concern was assessed with material uncertainty about the timing of receipt of claims not reliably forecast, and the outcome of negotiations that depended on agreements and a prolonged period for disposing of significant assets.

Another company disclosed events and conditions in this section, such as loss and liquidity pressure from losses, challenging conditions, and the requirements of *IAS 1*.

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Mitigation strategies were proposed; for example, to expedite the completion of loss-making contracts and to minimise losses. Subsequent events were itemised, such as reduction of the overdraft facility, and key assumptions were supplied; for example, the uncertain timing and quantum of claims and awards due, that insurance claims would be finalised, and customers would be able to pay. Management indicated that, if projections not realised, cash resources would be materially impacted. Management admitted the existence of material uncertainty pertaining to the timing and size of the cash inflows in the cash flow forecast.

The last company disclosed, under significant judgements, the events and conditions for the insolvency (current liability exceeds current assets) and the liquidity position, trading conditions and losses. The assumption was that losses were significant events, and this section of the financial statements gave reasons for the loss events; that is, onerous contract charges and unmaterialised, unsecured work. The section mentioned the *IAS 1* requirements regarding going concern assessments. In assessing going concern and management of liquidity, management prepared budgets and liquidity models, and a cash flow forecast. The company indicated it appointed independent external advisors and contract officers to review the budgets and contract assessments. The company monitored key contracts separately.

In addressing the possibility of losing cashflows, a detailed initiative was developed to improve liquidity and performance of the company, and implementation was regularly monitored. The initiatives comprised the closure of businesses not making profit after evaluating these against internal skills and market demand. These initiatives were at an advanced stage and the company expecting cash inflows from claims relating to contracts.

A key assumption was that secured contracts would trade at their forecast tender margins; the current liabilities included the bridge funding and costs associated with loss making contracts; disposal of Joint Venture assets to settle the funding and improve liquidity would address the solvency and liquidity position. The judgements and assumption applied by the company included the admittance to the existence of material uncertainties.

In the preparation of the financial statements, the directors had considered the financial plans and forecasts, and the actions taken by the company and, based on the

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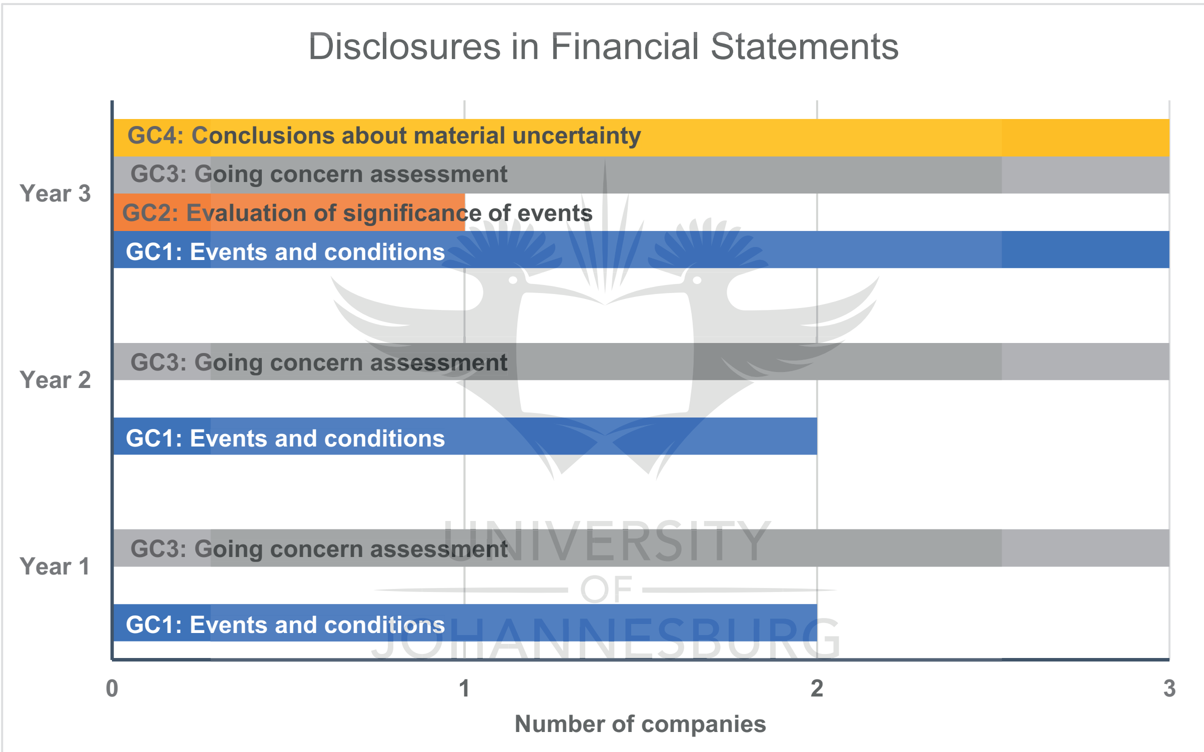
information available to them, were of the opinion that the going concern assumption was appropriate.

4.4.2 Overall assessment of the nature and extent of going concern disclosures

Figure 4.1 below shows the nature and extent of going concern disclosures.

Figure 4.1: Overall going concern disclosures in years 1, 2 and 3



Source: Own construction

It can be determined from Figure 4.1 that, in the first and second year, two companies disclosed the events and conditions (GC1). In the last year, all companies disclosed events and conditions. Generally, companies disclosed (GCI).

Companies generally did not indicate how events and conditions were evaluated to determine their significance (GC2). One company disclosed this in year three. Though this is considered by auditors in assessing going concern disclosure, the *IFRSs* have no such requirements.

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All companies disclosed the going concern assessment performed in all years (GC3). This is because it is a requirement of *IAS 1*. The *IFRSs* on disclosure do not specify how much should be disclosed by management about the assessment; they leave this to *IFRS* requirements for judgements.

In the first and second year, companies were not aware of any material uncertainties therefore did not disclose any. In the last year, all companies became aware of material uncertainties therefore disclosed then (GC4). There is no guidance as to the extent to which the material uncertainties should be disclosed; the *IFRSs* also leave this to the requirements on judgements.

Generally, there is a link or positive relationship between disclosures in different locations.

4.5 THE QUANTUM OF GOING CONCERN DISCLOSURES

The number of going concern words used in each of the statements and reports were counted and Table 4.5 below details the recorded numbers in each year leading to business rescue.

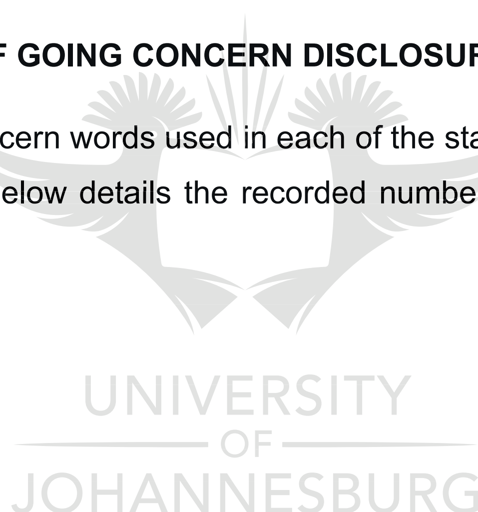

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Table 4.5: Quantum of going concern disclosures

Disclosure Element	1st Year				2nd Year				3rd Year			
	Basil Read	Esor	Group Five	Total	Basil Read	Esor	Group Five	Total	Basil Read	Esor	Group Five	Total
Directors' Responsibility Statement	51	38	50	139	0	154	50	204	0	154	55	209
Audit Committee and Risk report	30	0	0	30	127	0	0	127	225	224	25	474
Directors report	223	76	86	385	128	175	86	389	98	1727	184	2009
Significant Accounting Policies, including assumptions, estimates and judgements, and notes to the financial statements	0	191	0	191	582	173	0	755	878	727	4522	6127
Totals	**304**	**305**	**136**	**745**	**837**	**502**	**136**	**1475**	**1201**	**2832**	**4786**	**8819**

Source: Own Construction

In can be determined from Table 4.5 above that, in the first year towards business rescue, the directors' reports contained most going concern words, while the audit committee reports had the least.

In the last two years, the significant accounting policies sections contained most going concern words. In the second year, the audit committee reports had the fewest words, and in the third year, the directors' responsibility statements had the fewest words.

The highest quantum of going concern disclosures was 4522 words in the significant accounting policies. This is because the companies provided more detailed assessments, with liquidity models, and plans to mitigate the identified events and conditions casting doubt on company's continuity, key assumptions used, as well as the conclusions on materials uncertainty.

The audit committee reports contained the fewest disclosures in all years – 30 words. This is because the audit committee mainly monitors and reviews the assessments done by management.

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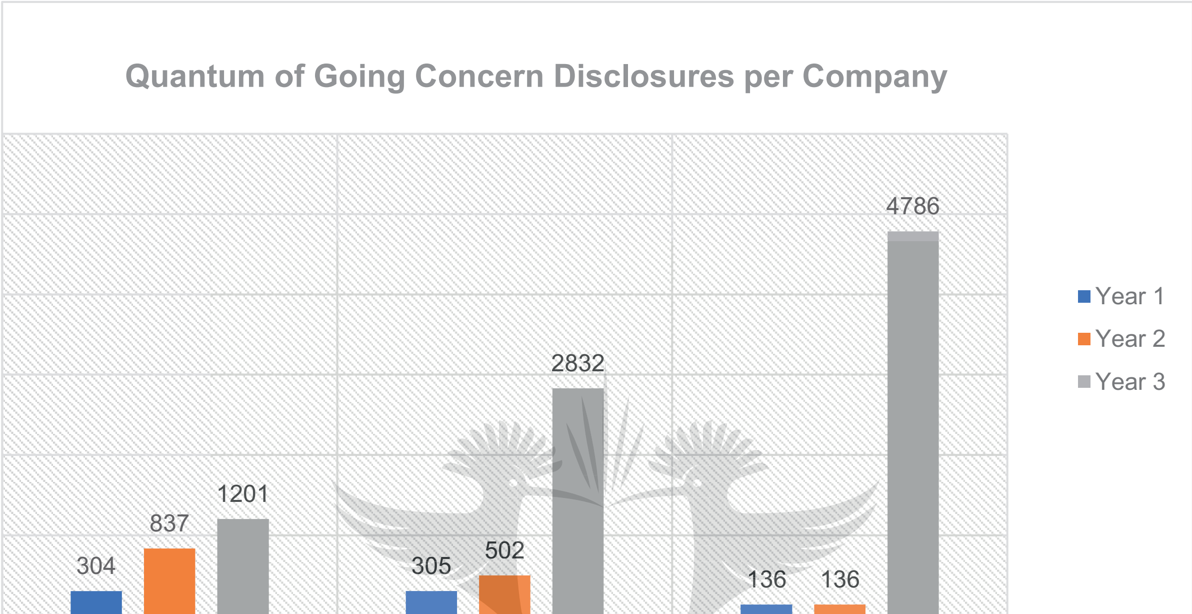
The study was undertaken in order to establish the quantum of words pertaining to the going concern disclosures each year. The details of the findings of the general results are shown in Figure 4.2 below:

Figure 4.2: Overall assessment of the quantum of going concern disclosures



Source: Own construction

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It can be determined from Figure 4.2 above that, in practice, going concern disclosures increase as the company is going through financial distress towards the rescue proceedings of the business. This is largely triggered by the uncertainties in the company's state of affairs.

One company's increase in going concern disclosures was consistent over the years, whereas the other two companies provided a significantly increased number of disclosures in the year when the company's business rescue was impending, compared to the first and second years. This aggressive provision of disclosures in the year of business rescue was because the companies then expanded on their mitigating plans and methods and the robustness in their going concern assessments.

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4.6 COMPLIANCE WITH IAS 1 REQUIREMENTS PER THE IFRS CHECKLIST

In terms of *IAS 1*, there are basically two disclosures required:

- **GD1**: Assessment of an entity's ability to continue as a going concern.
- **GD2**: Material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern.

The findings of the analysis are highlighted in Table 4.6 below:

Table 4.6: Analysis of going concern disclosure compliance with IAS 1

Code	Year 1	Year 2	Year 3
GD1	100%	100%	100%
GD2	0%	0%	100%
Overall	**50%**	**50%**	**100%**

Source: Own construction

Considering the requirements of *IAS 1*, there was generally a good level of entities adhering with those disclosure requirements. Companies were committed to comply with the *IFRSs* suggesting they are willing to assist users with information that enables them to make useful decisions.

In years 1 and 2, companies did not disclose material uncertainties because they are only required to comply if aware of such. The quality of disclosures varies from one company to the next. As noted above, in some cases, companies detailed the inputs, estimates and judgements in the going concern assessment, while others did not. With regard to material uncertainty, all companies referred to the timing and quantum of the cash flows. Some companies identified cash flows that were not certain, while others did not.

4.7 CONCLUSION

Based on the detailed analysis performed on the going concern disclosures, there were notable trends pertaining to the going concern disclosures that may require attention in financial reporting for the IASB, management of companies, users and auditors of financial statements.

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No inconsistencies were identified in the areas where going concern disclosures were included. If the information is spread throughout the document, this pose a challenge for the users to understand the full picture of the going concern status. This is where the use of referencing is important. This is justified by the fact that the *IFRSs* do not have a going concern disclosure standard that provides guidance on the location pertaining to those disclosures. Increased uncertainty about the affairs of the entity multiplies those inconsistencies because companies attempt to prove they can continue as going concerns by disclosing in all locations.

While location differed, there was consistency in the disclosures used by companies in the going concern notes. Generally, disclosures pertaining to going concern position were included in all the statements in the year of business rescue. Of the three companies assessed, going concern information was disclosed primarily in the director's reports, followed by the directors' responsibility statements, then the audit committee reports, and finally with the significant accounting policies.

IAS 1 does not indicate when the assessment should be done yet the requirement to perform going concern assessments is core of the principle of going concern. In all years, companies did not specify when their going concern assessments were performed.

A few companies provided details about the timing of cash flow forecasts. Most companies performed 12-month cash flow forecasts, but one company performed a 15-month cash flow forecast. This is consistent with *IAS 1.* There were inconsistencies as to when the cash flow forecasts should be prepared; either the date of the audit committee reports, or of the financial statements and or of the directors' report. The IFRSs do not have a standard that specifies the commencement date of cash flow forecasts. The *IFRSs* do not have a going concern disclosure standard that specifies when these going concern assessments should be performed.

Concerning the disclosure of events and conditions, going concern assessments, and material uncertainties, two companies disclosed events and conditions in the first two years. Then in the last year, all companies disclosed events and conditions. Generally, the events and conditions were disclosed by the companies. Companies generally did not indicate how events and conditions were evaluated to determine their significance;

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only one company in year three disclosed this. Though auditor evaluate this, the *IFRSs* have no such requirements.

All companies disclosed the going concern assessment performed in all years. This was because *IAS 1* requires management to assess an entity's ability to continue as a going concern. The *IFRSs* on disclosure do not provide how much should be disclosed by management; they leave this to the *IFRSs* requirements on judgements.

In the first and second year, companies did not disclose material uncertainties because they were not aware of any. In the last year, all companies became aware of material uncertainties and therefore disclosed them. There is no guidance as to the extent to which the material uncertainties should be disclosed. The *IFRSs* also leaves this to the requirements on disclosing judgements. Generally, there was a link or positive relationship between disclosures in different locations.

There was a trend for going concern disclosures to increase as the company moved through financial distress towards business rescue. This was mainly due to the increased material uncertainties encountered by the entities. One company's increase in going concern disclosures remained constant over the years, whereas other companies provided significantly more disclosures in the third year, when business rescue was impending, than in the first and second years. There was aggressiveness in providing disclosures in the year of business rescue as the companies expanded on their mitigating plans and methods and robustness in their going concern assessments.

There was generally a good level of adhering with the *IAS 1* disclosure requirements by all the entities. Companies seemed committed to complying with the *IFRSs* and providing users with information that would enable them to make useful decisions. In years 1 and 2, companies did not disclose the material uncertainties because they are only required to comply if aware of such.

The quality of disclosures varied from one company to the next. In some cases, companies detailed the inputs, estimates and judgements in the assessment, while others did not. With regard to material uncertainty, all companies referred to the timing and quantum of the cashflows. Some companies listed the cash flows that were not certain while others did not.

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CHAPTER 5. CONCLUSIONS AND RECOMMENDATIONS

5.1 INTRODUCTION

This study was undertaken in an attempt to analyse the financial statements of South African listed companies that went into business rescue in order to identify significant trends relating to their going concern disclosures. This chapter provides the conclusions pertaining to the study, as well as recommendations for prospective research.

5.2 SUMMARY OF FINDINGS AND CONCLUSIONS

The study articulated that there were inconsistencies in the location of going concern disclosures found in financial statements. In that regard, the use of referencing was made indispensable for giving the full picture of the going concern status of those financial statements.

This is caused by the fact that *IFRSs* do not have a disclosure standard that provides guidance on the location of those going concern disclosures. The growing uncertainty regarding the company's ability to continue as a going concern increased those locational inconsistencies because companies made efforts to prove that they are a going concern by disclosing uncertainties throughout the financial statements. Generally, there was a link or positive relationship between disclosures in different locations.

Companies performed 12- to 15-month cash flow forecasts. The *IFRSs* open the way for inconsistencies by stating merely that forecasts must be made "at least 12 months from the date of the report". Companies started their cash flow forecasts variously beginning from the date of the audit report, of the financial statements and of the directors' report.

The *IFRSs* do not include a standard that stipulates when going concern assessments should be performed.

Companies generally did not indicate how they evaluated events and conditions to determine their significance. Though the evaluation method is considered by auditors in assessing going concern disclosure, the *IFRSs* have no specifications.

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The *IFRSs* do not specify the extent of the disclosures that should be included by management; they leave this to the *IFRSs* specifications for the use of judgement. There is no guidance as to the extent to which the assessments of going concern status and material uncertainties should be disclosed. Going concern disclosures certainly increased as a company passed through financial distress towards business rescue. There was a tendency to make disclosures more aggressively in the year of business rescue, when the companies expanded on their mitigating plans and the methods and robustness of their going concern assessments. This was because disclosures were not entity-specific and merely followed a norm in the industry.

Companies provided users with the information that would enable them to make useful decisions.

All the entities displayed a good level of adhering with the disclosure requirements of *IAS 1*. Even in years 1 and 2, when companies did not disclose material uncertainties, they were compliant because they were unaware of the uncertainties then. The quality of disclosures varied from one company to the next, depending on the judgements applied.

5.2.1 Usefulness of these findings and conclusions

The results of this study will be useful to users of financial statements because, before purchasing shares in a company, they can take precautionary measures to detect possible business rescue based on the variability of financial disclosures over the years. This will improve the decision-making usefulness of disclosures.

The IASB will benefit from this research because it can improve the Disclosure Initiative to deal with the discrepancies in applying the disclosure requirements. It will be able to advise how to communicate financial disclosures in such a way that users are made aware of them. This should avoid an overload of duplicate or irrelevant disclosures that expose investors to the risk of confusion.

Furthermore, the study will enable auditors to perform their own similar trend analyses to identify any doubts that may arise. They will be better able to evaluate management plans and whether they can be implemented effectively.

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5.3 RECOMMENDATIONS

The following recommendations are proposed, which considered the concerns raised in the IASB's Disclosure Initiative:

- There must be consistency in the location of going concern disclosures for easier navigation of the financial statements.
- There must be consistency in when going concern assessments are performed, for comparability purposes.
- The quantum of going concern words should not constitute an overload of information but an indication of disclosures additional to those in previous financial statements, based on the existing information.
- Disclosures must be entity-specific and not merely follow a norm in the industry.
- The following should be considered for each statement and report in the financial statements:

  a) The director's responsibility statement should only mention the directors responsibility regarding going concern, which then makes a reference to the statements where assessment was performed, and models applied. This avoids overload of information.

  b) The audit committee report should indicate that it *interrogated* (the word used in the industry) the assessment made by management and should provide conclusions about it. The audit committee can also explain how this was done, with detailed input. The audit committee can then make a reference to the note where the assessments are performed. This provides a linkage of information and good referencing techniques and avoids information overload.

  c) The directors' report should indicate that management considered the appropriateness of going concern and make reference to the notes. This provides a linkage of information and good referencing techniques and avoids information overload.

  d) Under significant judgements and estimates, management should communicate the models applied and inputs used, the judgements applied to those inputs and the conclusions reached. With regard to material

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uncertainties, management should include detailed information and indicate where the uncertainty lies.

- To align with *IAS 570*, the IASB should consider having a separate disclosure listing events and conditions, how these should be evaluated and, where they are significant, provide mitigating plans, and validate the judgement applied in determining the significance of the conditions. This would avoid repetition of information in the financial reports.
- An independent company that deals with business rescue should be engaged when there are indicators that business rescue might be necessary. Based on its knowledge of business rescue proceedings, the independent company should review forecasts and the entity's going concern assessment and provide a report to auditors, which can then be used as corroborative evidence.
- Going concern status should be considered for longer than 12 months, to be in line with the new *IFRS 9*, which considers the forward-looking information of the instrument on the calculation of expected credit losses (ECL). The ECL models should consider the life of the outstanding information.

5.4 CONSIDERATIONS FOR FUTURE RESEARCH

There are several things researchers should consider in extending this existing research:

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a) Identify the relationship between going concern disclosures and audit reports to determine corroboration. Research the relationship to determine whether management and auditors speak the same language.
b) Identify the relationship between variables such as company size, auditor size, and the level of going concern disclosure.
c) This research focused on one type of industry because the information was not readily available for other industries. Devise qualitative trend analysis methods to identify the nature of financial disclosures in other industries.
d) Conduct research relating to *IFRS* 7 credit risk disclosures on the approaches to modelling ECL, with the introduction of *IFRS* 9.

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