TOWARDS AN UNDERSTANDING OF ACCOUNTING AND SOCIETY: SOME EPISODES IN THE FORMULATION AND DEVELOPMENT OF THE GOING CONCERN CONCEPT

by

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CHAPTER 6

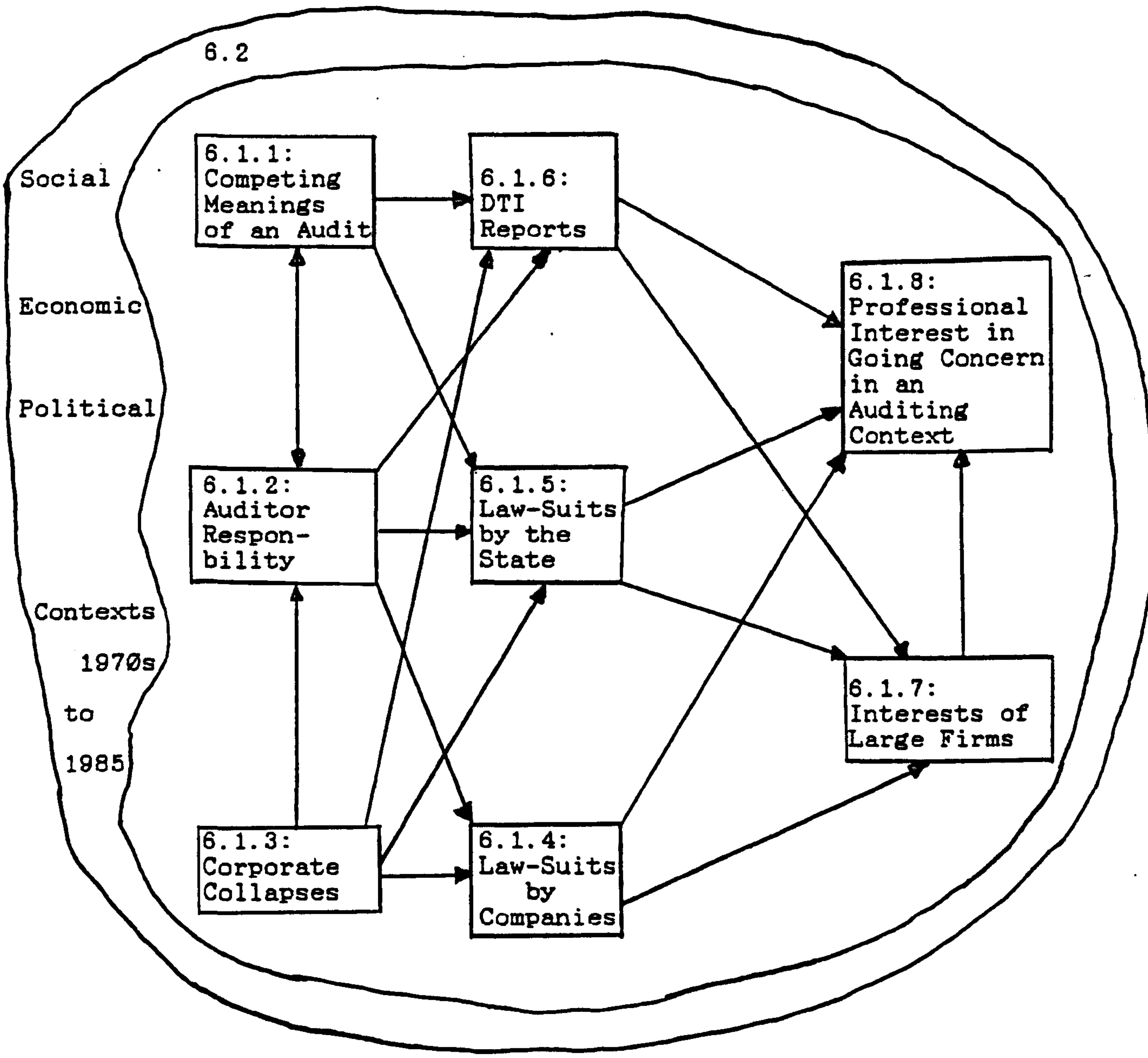
AUDITOR AND GOING CONCERN 1970s-1985: AN EXPLANATION IN THE CONTEXT OF SOCIAL ECONOMIC AND POLITICAL DEVELOPMENTS

6.0: Introduction

By 1971, the UK profession began to describe the going concern concept as a 'fundamental' and a 'generally accepted' accounting concept. Chapter 5 explored the factors which led to the institutional recognition of the concept. This chapter now focuses on the meanings of the concept in an auditing context which began to emerge from the 1970s onwards. Prior to this period, literature had little to say about its meanings in an auditing context (see chapter 3). But from the early 1970s, the discussions of the concept in an auditing context began to be widespread. Why did discussions of the concept in an auditing context take-off in the 1970s? Within the methodological framework of chapter 2, this chapter will identify a number of influences which brought the concept in an auditing context to the forefront.

In order to present the various arguments, this chapter, as figure 6.1 shows, is divided into two broad sections. The first part (6.1) focuses on a number of developments which formed a cradle for the discussions of the concept in an auditing context. These related to the contested nature of the meanings of an audit (6.1.1), uncertainties about auditor responsibilities (6.1.2) and the impact of corporate collapses (section 6.1.3). A combination of these factors gave rise to new kind of pressures from the State in the shape of critical Department of Trade inspectors' reports (6.1.4) and lawsuits from the State (6.1.5).

Figure 6.1
An Overview of the Chapter



Further pressures came from lawsuits by various fractions of capital (6.1.6). Such developments gave particular visibility to the interests of large auditing firms (6.1.7) which may have given them incentives to promote some meanings of the concept. Section 6.1.8 argues that a combination of the aforementioned developments placed the going concern concept in an auditing context on the professional agenda. Section 6.1.9 concludes the first part with a summary.

The discussions of going concern in an auditing context did not arise in a sociopolitical vacuum. They coincided with what many scholars call the end of the 'longest economic boom' (Allen and Massey, 1988) and the beginning of massive structural changes[1] (Gough, 1978; Armstrong Glyn and Harrison, 1984; Cox, 1986) in industry. This period is noted for the continuing prominence of 'finance capital' (Coakley, 1984), a breakdown in the international and national structures of regulation (Coakley and Harris, 1983), global interdependence of capitalism (O'Connor, 1987) and significant shifts in State policies (Bosanquet, 1983; Hall and Jacques, 1983). The period witnessing the increasing discussions of the concept is particularly marked by the decline of a traditional manufacturing base (Harris, 1988), making the UK an importer of manufactured goods rather than the traditional exporter (table 6.1). During this period, Britain experienced high rates of inflation (table 6.2); the highest ever nominal rates of interest (table 6.3) and real rates of interest (table 6.4); falling rates of profitability (table 6.5) and liquidity (table 6.6); highest ever number of liquidations (table 6.7) and under the influence of new technologies and divisions of labour (Massey, 1988; Meegan, 1988), high unemployment (table 6.8). Against such a background, the second part (section 6.2) considers a number of interconnected episodes and events which formed a significant backdrop for the profession's deliberations on the going concern concept. These relate to continuing attempts to revive the ailing British economy (6.2.1), a property and banking collapse (6.2.2), continuing decline of the economy (6.2.3) and the rise of the 'New Right' (section 6.2.4) which adopted a particular way of managing the economy. After a summary of the second part (section 6.2.5), section 6.3 concludes the chapter with a discussion and summary.

6.1: FACTORS INFLUENCING THE MEANINGS OF THE GOING CONCERN CONCEPT IN AN AUDITING CONTEXT

The discussions of the going concern concept in an auditing context began to be voluminous in the early 1970s. Some of the meanings and implications were shown in figure 3.5 (page 156). Increasingly, it was being associated with questions of corporate profitability, solvency, liquidity and survival. By issuing going concern qualifications, auditors were expressing doubts about the ability of a business to continue in existence. Auditors were increasingly being urged to pay attention to accounting ratios, post balance sheet events, corporate forecasts, budgets and plans to determine solvency and liquidity of businesses. Such interpretations seemed to coincide with the earlier literal interpretations in which going concern was interpreted as a business which will continue.

The literature began to suggest that the going concern concept required the auditor to comment upon corporate survival. The profession, however, did not wish to acknowledge such audit objectives. The multi-accented nature of an audit and the struggle over its ascendant meanings provided a backdrop for the discussions of the concept[2]. A further boost was given by the legal developments which enabled third parties to sue auditors for negligence. Such developments changed the balance of power between auditing firms and 'significant others'. This coincided with a major economic downturn in which many businesses collapsed.

In professional circles, compliance with the going concern meant that the "enterprise will continue in operational existence for the forseeable future" (ASC, 1971, para 14). In many cases, the business failures occurred soon after a company received an unqualified audit opinion. Thus, whenever a business with an unqualified audit opinion ceased trading, attention focused upon the legitimacy of the audit procedures and the opinion. Many parties alleged that "the auditors knew far more than their reports disclosed" (Woolf, 1986a, page 511). Upon the collapse of a business, the 'significant others' frequently invoked one of the competing meanings of going concern (and audit) and sought damages by issuing law-suits. Indeed, some well publicised company failures and their implications for auditor liability have been the main instigators of discussions about going concern in an auditing context (Coopers and Lybrand, 1987). The law-suits were issued not just by companies, but also by the State in its capacity as a 'fraction of capital'. To manage the crisis of legitimacy caused by a large number of corporate collapses, the State conducted a large number of investigations and found that the extant auditing practices were deficient. The resulting criticisms had implications for the meanings and interpretations of the going concern concept in an auditing context.

The remainder of this section provides further details of the arguments outlined above.

6.1.1: Meanings of an Audit

The word 'audit' is multi-accented and does not have a fixed meaning. Each meaning competes for space and depending upon the power of the competing groups, gains ascendancy. Within this context, the meanings of going concern are also contested.

In the late nineteenth and early twentieth century, when accountants were mainly concerned with bankruptcy and liquidation work, audits were primarily associated with detection and reporting of fraud (Dicksee, 1892, page 6). With emphasis on fraud detection, the courts expected auditors to pay particular attention to corporate solvency (Lee, 1979). However, as the accountancy profession grew in strength and social status, audit objectives became more ambiguous. From the mid-twentieth century onwards, in professional circles, the primary audit objective is assumed to be 'attesting credibility to financial statements' (Lee, 1982; Waldron, 1978). In this context, it is interesting to note that the Companies Acts do not define the meaning of an audit, though it is acknowledged that an auditor is required to give an opinion stating whether the financial statements show a 'true and fair' view. Such an expression itself remains ill-defined and misunderstood (Skerratt, 1982). It is frequently the subject of struggles between various parties who assign competing interpretations in order to challenge and advance some preferred meanings of an audit (Chastney, 1975).

In such a struggle, the profession argues that an auditor does not express opinion on management quality and does not give assurance that a business is a going concern (Shaw, 1980, page 16). Furthermore, auditors are assumed not to be primarily responsible for reporting and detecting fraud (Allan and Fforde, 1986), though some continue to argue that 'detecting fraud and errors' is a secondary objective (Millichamp, 1978, page 3). The accountancy firms argue that they plan and conduct their work with a view to discovering "major irregularities and fraud" (Thomson McLintock, 1983, page 8). The profession argues that it has little or no responsibility for alerting the readers of accounts to financial unsoundness, likelihood of insolvency, corporate inefficiencies and so on (Lee, 1982, pages 105-107). Through the professional education processes, the profession's views on audits are legitimised. When numerous auditing books repeat the same meanings of an audit and hardly present any competing meaning, after a time that meaning begins to assume a sense of concrete reality (Sikka, 1987). The students and aspiring accountants are made to feel that they belong to some 'imaginary community' which shares some dominant beliefs. Even if the professional bodies assent to some meanings of an audit, other groups are always capable of challenging such meanings.

Numerous research studies (for example, Lee, 1970; Beck, 1973; Briston and Perks, 1977; Arrington, Hillison and Williams, 1983; Purewal and Sikka, 1987) have shown that many private and institutional shareholders and other users have audit expectations contrary to those acknowledged by auditors (i.e. an 'expectations gap' exists). Such studies have shown that contrary to the professional statements, 'significant others' expect auditors to detect and report fraud, warn of the likelihood of bankruptcy, inform of financial unsoundness, give assurances on solvency, report on efficiency and comment on company forecasts and competitiveness. Beck (1973) reported that 81% of the shareholders expected the auditor to assure them that the company being audited is financially viable. The professional bodies are well aware that the public expects auditors to report on the factors affecting the likely survival, solvency, liquidity and bankruptcy of a company, i.e its ability to remain a going concern (Connor 1986; Mednick, 1986; The Accountant's Magazine, February 1987, page 19). The perception that an auditor is concerned with the survival of a company is promoted by the very processes of auditing. During the course of an audit, an auditor pays an almost obsessional attention to internal controls, stock counts, uses accounting ratios to diagnose corporate health, acertains cash at bank, bank overdrafts and even counts petty cash to the last penny. Such auditing procedures create the feeling that the auditor is concerned with the future well being of a company.

The competing meanings of an audit reflect the 'interests' of the parties involved. A President of the Institute of Chartered Accountants in Ireland (ICAI) argued,

> "Don't blame the auditors immediately a business fails ...... Most business failures are due to management failures. People simply misunderstand the role of the auditor" (The Accountants Magazine, 25th April 1985, page 2).

The conflicting interests of the various groups frequently become visible whenever a company ceases to be a going concern unexpectedly. Within the dynamics and contradictions of capitalism, such liquidations are inevitable and necessary for mobility of capital. However, such a reality can threaten confidence in the capitalist order and thus cannot be easily presented to the masses. Instead, a very selective (inevitably distorted) version is presented. Corporate collapses are presented not as an inevitability, but in a moral sense. Liquidations are not shown to be the result of competition, tensions between labour and capital, fractions of capital and the profit motive, but the fault of directors, auditors, irrational decision-making, government policies and so on. Thus, ideology presents a particular and distorted view of the world. The question then becomes who has acted irrationally or immorally and is thus responsible for the corporate collapse, or whose actions might have prevented a collapse? In this context, the contested nature of auditor responsibility affects whether some meanings of going concern will become more critical or dominant and whether auditors would be forced to assign/accept particular interpretations of the concept.

6.1.2: Auditor Responsibility

Under the Companies Acts, an auditor is appointed by the shareholders and reports to them. However, there are ambiguities in who exactly is entitled to rely upon audited financial information. The capital, finance and credit markets require information and the profession and the State promote audited information as 'reliable' information. In a quest for social legitimacy, the professional bodies argue that not only investors, but creditors as well, are legitimate users of audited information (FASB, 1978). Some publications such as 'The Corporate Report' (ASSC, 1975) argue that almost every member of society has a reasonable right to receive and use information. Such views reflect ambiguities about the nature of auditor accountability. For example, are the auditors just responsible to the company, shareholders collectively, shareholders individually, creditors, investors or society generally? In this context, case law plays an important part. The court decisions can open up or constrain opportunities of legal actions against auditors and thus have consequences for the wealth of partners and the ability of the firms to reproduce themselves. Case law is also a consequence of the continuing tensions between accountancy firms and other fractions of capital.

By the 1950s, British case law had established that in the absence of a contractual obligation, a third party could not succeed in any civil action against auditors. Such a principle was reaffirmed in the case of Candler versus Crane

Christmas & Co. (1951) 2 K.B. 164 and there were very few direct challenges to it. However, with the developments in credit, banking and capital markets and their reliance on audited financial information, such principles came to be challenged. The most celebrated challenge came in the aftermath of Hedley Byrne & Co Ltd v Heller & Partners Ltd (1964) A.C. 465; (1963) 2 All E.R. 575; (1962) 1 Q.B. 396. This case did not involve auditors directly, but had implications for auditors, especially as audited financial information is used for a wide variety of investment and credit decisions. In his judgement, Lord Morris, stated that

> "........ if someone possessed of a special skill undertakes, quite irrespective of contract, to apply that skill for the assistance of another person who relies on such skill, a duty of care will arise .... if in a sphere in which a person is so placed that others could reasonably rely on his skill or on his ability to make careful inquiry, a person who takes it on himself to give information or advice to, or allows his information or advice to be passed on to another who, as he knows or should know, will place reliance on it, then a duty of care will arise" (Judgement delivered in Hedley Byrne & Co Ltd v Heller & Partners Ltd (1964) A.C. 502 and 503).

Following this landmark decision, the Institute of Chartered Accountants in England and Wales (ICAEW) became concerned with the likelihood of increased litigation against auditors and in 1967 sought a Counsel's opinion. The Counsel concluded that the

> "Accountants may now be held in law to owe a duty of care to persons other than those with whom they are in a contractual or fiduciary relationship and may be liable for neglect of duty if, but only if, they knew or ought to know that a financial report, account or statement prepared by them for a specific purpose or transaction, will be shown to a

> particular person or class of persons in that particular connection" (section V8 of the ICAEW handbook).

The principle of Hedley Byrne was subsequently affirmed in the Canadian case (not involving accountants) of Myers v Thomson & London Life Insurance Co. (1967) and the Australian case of Evatt v Mutual Life and Citizens' Assurance Co (1971) 1 All E.R. 150. Such cases placed further question marks against the extent to which an auditor might be held liable and the damages which might be awarded against him. Hardly any case involving auditors came to the courts, but the ICAEW reflected its concern by saying that

> "there are more and more claims against accountants, both as regards size and incidence and diversity of alleged negligence. .... Majority of claims in the UK emanate from failure to discover defalcations and taxation in general, although several other areas are beginning to appear prominent .... As yet, few very substantial cases have been brought against British accountants but the frightening prospect, both for accountants and their underwriters, is the possibility that the anti-accountant litigation ...... will spread ......" (Accountancy, February 1971, page 65).

Most of the claims continued to be settled by out-of-court payments, especially as many accountancy firms were reluctant to have some principles of responsibility enshrined in law. The ICAEW advised (as reproduced in The Accountant, 10th August 1972) its members to use 'professional disclaimers' to limit and avoid liability and continued to offer further advice along similar lines (The Accountant, 19th April 1973, page 526; The Accountant, 19th September 1973, page 527).

As the mid-1970s economic crisis worsened and the number of liquidations increased, new threats to auditor liability appeared. In suing auditors, the plaintiffs argued that they expected auditors to report whether a company was a going concern. A widespread view was that the auditors

> "must have known that the company was going to the ground" (The Accountant, 6th May 1982, page 4).

Around this time articles on going concern, prompted by the economic crisis and its implications for auditor liability, began to appear. The Institute of Chartered Accountants of Scotland (ICAS) asked Strachan (1975), a Peat Marwick partner to indicate a possible audit approach to going concern issues. In the first UK institutional statement on 'going concern' in an auditing context, the ICAS wrote,

> "....... it may be that in present circumstances sooner or later a judge may decide (or may decide otherwise) that an auditor should not be expected to be a crystal-gazer ......"
>
> ...... the auditor has to think of his responsibility to shareholders, in that, accounts purporting to give a true and fair view on a going concern basis having been prepared, he may have doubts on whether the company may continue to be a going concern" (The Accountant's Magazine, February 1975, page 64).

In 1976, as a way of controlling the incidences of claims against auditors, the ICAEW was suggesting a formula of 10 times the audit fee or a maximum of £500,000, whichever is the lowest. Cases (not involving accountants) such as Anns v Merton London Borough Council (1978) A.C. 728; (1976) Q.B. 882 extended the Hedley Byrne principle, but the auditing cases reaching the courts remained almost nil. Indeed, the question of auditor responsibility remained remarkably ambiguous and was rarely directly tested in the courts until 1981.

The case of JEB Fastners v Marks Bloom & Co (1983) All E.R. 583; (1981) 3 All E.R. 289, directly involved the auditors of a recently liquidated company and for the first time established that under certain circumstances, they owe a 'duty of care' to third parties even in the absence of any contractual relationship. The main points of this case were subsequently confirmed by a court of appeal. The Scottish case of Andrew Oliver and Son Ltd v Douglas (1982) SLT 222 also suggested that an auditor owes a duty of care to third parties. The subsequent case of Twomax Ltd and Others v Dickson, McFarlane and Robinson (1983) S.L.T. 98 once again related to proceedings against auditors after the company had ceased to be a going concern. It affirmed the JEB Fastners principle and actually awarded £65,000 damages against auditors to three shareholders who suffered a loss by relying upon the negligently audited accounts. Such cases acknowledged wider auditor responsibility and with it increased the likelihood of litigation against auditors, especially if investors could demonstrate that they had incurred losses by relying on negligently prepared audited accounts. Such developments continued to provide the cradle for going concern discourses and persuaded the professional bodies to advance particular meanings of the concept in order to protect the interests of their members.

It is during such a time (Spring 1982) that the Auditing Practices Committee set up a working party. It was formed because

> "........ We were in the throes of a recession and the situation was becoming worse .... the question of auditor liability was becoming extremely important .... a lot of different perceptions existed out there about our responsibility and somebody screamed for a paper on going concern ...... and a working party was hastily assembled" (A member of the APC working party).

To sum up, this section has argued that the discussions of the going concern concept in an auditing context gathered pace because the scope of auditor responsibilities had been widened. This happened at a time when the meaning of audit was being contested by 'significant others'. In this environment, the case law responded to changes in financial and capital markets by giving recognition to the value of audited information. Previously, third parties could not sue auditors, but now they could. In their claims against auditors, the third parties invoked competing meanings of an audit and with it, competing meanings of accounting principles. The threat of lawsuits themselves was located in wider economic crises. Falling profitability and liquidity ratios were the symptoms of such crises. These crises resulted in a large number of corporate failures and drew further attention to the nature of an audit and the meanings of going concern.

6.1.3: Corporate Failures

The discussions of going concern in an auditing context became widespread against a background of falling profitability (table 6.5), falling liquidity ratios (table

6.6) and a rising number of corporate insolvencies (see table 6.7). In such an economic downturn, questions began to be raised about the meaning of an audit, especially as many companies collapsed within weeks of receiving an unqualified audit opinion. A major issue was whether

> "the seed of failure had been sown at the time of the previous audited accounts and, if so, whether the auditors should have recognised this and varied their report to take account of the position" (Coopers & Lybrand, 1987, para 8.1).

In many cases, the auditors claimed that the accounts were 'true and fair' and complied with 'generally accepted accounting principles', but the companies were not going concerns any more. The increasing rate of corporate failures and their implications for auditor liability, made going concern a major issue for the UK accountancy bodies (The Accountant's Magazine, February 1975, page 64). In a volatile economic environment, with lawsuits by third parties a possibility, the accountancy firms felt threatened and started to devote greater attention to the meanings of going concern. As an editorial in Accountancy noted,

> "In the difficult days that undoubtedly lie ahead, auditors will be forced increasingly to think in each individual case whether the going concern concept is satisfied - something which has rarely been necessary to consider in the past" (November 1974, page 5).

These 'difficult days' related to the collapse of the secondary banking and property sectors where asset values were falling alarmingly (see section 6.2 for a discussion). In this context, the profession was even prepared to downgrade the implications of its 'fundamental' accounting concepts. In 1971, the profession recognised, the going concern concept as a 'fundamental' concept (ASC, 1971). However, in the prevailing economic environment, many 'significant others' were interpreting the concept in a literal sense, i.e. they were expecting the accounts to give an indication of the probability of corporate survival. Any incorporation of declining market values in the financial statements would have shown erosion of capital, inhibited investment and might have made the crisis worse. In these circumstances, the ICAEW (1974) claimed that going-concern values are

> "unsuitable for use in relation to property assets of a company" (para 3).

The high number of corporate collapses and the continuing liquidity crisis led to a demand for an auditing standard on going concern by Percy and Logie (1976). In the face of a deepening recession, foreign competition, low profitability, escalating costs, inflation and corporate insolvencies, going concern qualifications became more common. The plight of Britain's major car manufacturer, the British Leyland Motor Corporation (BLMC) became highly visible with the publication of its 1974 accounts on 18th December 1974. Coopers & Lybrand issued a going concern qualification on the grounds that the company could only survive with continuous financial support from the State. Burmah Oil Company, another major company was also rescued by the Bank of England. Many auditing firm partners were anticipating "a number of spectacular failures in the next twelve months [and feared that] auditors would inevitably get much of the blame"[3].

The possibility of large corporate failures and their consequences for auditor liability had impact on discussions of going concern in an auditing context. Such fears persuaded the ICAS (1975) to issue guidance on going concern and commission an article. In an ICAS commissioned article, F.A. Strachan (1975), a Peat Marwick partner warned that

> "After the approaches to the government by The Burmah Oil Company Limited and the British Leyland Motor Corporation Limited (to name only the biggest companies), asking for financial assistance, every accountant and businessman in the United Kingdom must now consider whether the "going concern" concept still applies to the financial accounts of the business with which he is involved. If he does not, the practical consequences may be alarming ...." (page 65).

The same article also noted contemporary auditor anxieties relating to an increase in the number of liquidations, falling property values and secondary banking crisis.

By 1976, the profession had formed the Auditing Practices Committee (APC) to issue auditing standards. The first of these standards was not issued until 1980, but significantly the first edition of its bulletin 'True & Fair' contained advice on going concern. It noted that

> "In 1975 there were 9,849 liquidations in England, Wales and Scotland and the latest estimates suggest that 1976 will be a boom year in this respect, so don't assume the going concern basis is appropriate for all your clients - confirm that it is! (APC, 1976, page 5).

This concern with increased auditor liability, frequently resulting from corporate collapses, continued to provide the background for increasing discussions of the going concern concept in an auditing context. In 1982, the profession established a working party to consider the formulation of an auditing guideline. During this period, the number of corporate failures hit 16,893, roughly twice the number in 1974 and included household names such as Laker Airways and the State sponsored DeLorean Motor Company. By the time the APC issued an exposure draft of the going concern auditing guideline (APC, 1983a), the number of liquidations was approaching 18,141 (see table 6.7). In marketing the guideline, the working party chairman, Ray Hinton, wrote that

> "In the first half of 1983 there were nearly 2,500 compulsory company liquidations in England and Wales. In the public's mind, the auditor as one of the company's principal advisors is inevitably associated with these events" (Hinton, 1983).

The APC further referred to the connections between corporate failures, auditor liability and going concern discussions, by adding the following commentary to the exposure draft,

> "A company issues its accounts and a clean audit report - six months later it goes bust: angry customers, rueful creditors, heartbroken employees, wailing investors, a head-shaking public. Number one target for venting of this discontent will be directors. However, the auditors and the profession as a whole cannot realistically expect to escape criticism.
>
> In the first six months of 1983 there were 2363 compulsory company liquidations in England and Wales alone. A lot of anger, ruefulness, heartbreak, wailing and headshaking.
>
> Set against this socio-economic background, the exposure draft of an Auditing Guideline on the audit implications of going concern problems ...... is a very important document" (APC, 1983b, page 1).

This section has shown that the discussions of going concern in an auditing context were prompted by the high rate of corporate insolvencies. This, against a background of a contested nature of audit and changes in the case law position, gave many 'significant others' an opportunity to contest and sharpen issues about auditor liability. In this, they argued that the auditors had failed to provide the requisite legitimacy to the audited financial information and that thus, such accounts were misleading. The auditors faced increased litigation which threatened their wealth. The Department of Trade inspectors criticised the auditors' failure to highlight going concern problems. Such factors helped to propel discussions of the going concern concept and created an environment for institutional pronouncement.

6.1.4: Lawsuits from Companies

The discussions of going concern in an auditing context took place at a time when auditors were experiencing an increase in litigation. Such litigation frequently arose in the aftermath of companies ceasing to be going concerns.

In the 1970s, lawsuits began to increase because of the feeling that "In so many cases they [auditors] must have known the company was going to the ground" (The Accountant, 6th May 1982, page 4). The auditors argued that they had no responsibility for reporting on the financial unsoundness or the likelihood of corporate insolvency. An early opportunity to test the issue of auditor responsibility was provided by the Tremletts case, a company which ceased to be a going concern soon after receiving an unqualified audit opinion.

In October 1973, Tremletts acquired Tower Assets, a company audited by Arthur Young. Soon after the acquisition, cashflow and working capital deficiencies totalling nearly £5 million were discovered. In November 1974, the bankers refused to grant any further loans and the company ceased to be a going concern. In December 1974, receivers were appointed and Tremletts issued a law-suit (The Times, 17th January 1976, page 17) seeking damages of £5 million from auditors Arthur Young, merchant bankers and four company directors. The auditors were accused of negligence in detecting liquidity and financial problems. However, before the case could be heard, the defendants made an out-of-court settlement totalling £550,000 (The Times 22nd January 1976, page 23). The bulk of what was described as the "largest out-of-court settlement" involving accountants (The Times, 10th February 1976), was paid by Arthur Young and the financial world was relieved as a "lengthy court action might challenge some of the standards that up till now have been acceptable in the City".

By 1976, the number of liquidations in the UK reached 10,727. Whilst the ICAEW was lobbying for a financial limit on auditor liability, Coopers & Lybrand received a lawsuit of £1.3 million from Burnholme & Forder (The Times, 10th February 1976, page 17). In 1974, Burnholme & Forder bought a 35% stake in Brayhead Limited by relying on its 1973 published accounts and profit forecasts, but now alleged that the 1973 accounts did not show a true and fair view. Over the last few years of its life, Brayhead had been audited by Coopers & Lybrand, Joslyne Layton-Bennett (JLB) and Fuller Jenks. Following the collapse of Burnholme & Forder, a Department of Trade report was commissioned in 1975 and published in 1979. The report (DTI, 1979a) was critical of the management for preparing over-optimistic forecasts and for selecting accounting methods which served their personal interests and manipulated company profits. The company's accounting records were incomplete, confusing and contradictory and the accounts omitted some creditors figures altogether. The Inspectors ".... found evidence to suggest that ...... JLB had not adequately summarised the work carried out by their staff or recorded the results of any critical review ....." (DTI, 1979a, para 222). The outcome of the lawsuit is not publicly known.

The going concern concept received particular attention by the Auditing Practices Committee in the very first edition of 'True & Fair' in Autumn 1976. But further pressures came amidst the secondary banking and property collapse of the mid-1970s (discussed in section 6.2). Deloitte Haskins and Sells received an £8 million negligence lawsuit in connection with the collapse of London and County Securities, a secondary bank (Accountancy, August 1977, page 56). The collapse had been investigated by the Department of Trade inspectors (DoT, 1976a). The report noted a number of accounting irregularities, such as deliberate window dressing, back-dating of transactions, falsifying books and transactions, paying third parties to support share price and so on. The report was critical of auditors (see chapter 7 for more details) and the liquidator cited it as evidence in his law-suit against Harmood Banner (now part of Deloitte Haskins and Sells). The previous belief was that such evidence could not be cited in civil cases. High Court proceedings started on 15th January 1980 and on 28th January, the court judgement in the case of London and County Securities Ltd and others v Nicholson and others (1980) 3 All E.R. 861 broke new ground by establishing that the evidence included in a DTI report could be cited in civil and criminal proceedings against the auditors. In February 1980, Deloittes made an out-of-court settlement of £900,000 (The Times, 8th February 1980, page 17).

Another major firm, Arthur Anderson also faced litigation. In 1979, Christopher Melville MacLaren sued Arthur Anderson for damages of £453,000. Back in 1975 McLaren was considering investing in Media Electronics and asked Arthur Anderson to check the company's affairs. The firm gave the company a clean bill of health and McLaren invested heavily both in 1975 and 1976. But the business had been running at a loss for a number of years and in 1977 a receiver had to be appointed. McLaren alleged "professional negligence and breach of duty between 1975 and 1976" (Daily Telegraph, 28th June 1979, page 19) by Arthur Anderson. The firm first decided to contest the lawsuit, but then suddenly the damages claim was withdrawn after "out-of-court discussions at the High Court" and "no details were given of the terms of disposal" (Daily Telegraph, 26th July 1979, page 8).

Arthur Anderson, Deloittes, Robson Rhodes and Arthur Young were not the only firms facing extensive litigation. Ernst & Whinney were at the receiving end of a £1.8 million lawsuit relating to the affairs of the stockbroking firm Hedderwick Sterling. The dealings of the stockbroking firm of Hedderwick Sterling Grumbar had been the subject of Stock Exchange investigations in 1979 and 1980 after allegations of lending stock to other firms and failing to maintain adequate liquidity margins. The Fraud Squad had also investigated the firm's gilt dealings (Financial Times, 11th April 1981, page 1), but the firm was cleared. In view of its continuing liquidity problems and the loss of some key personnel, the firm was about to merge with a firm run by the Chairman of the Stock Exchange, but some irregularities were discovered and the merger was called off. Following a refusal by the National Westminster Bank to handle its cheques, the company collapsed with a deficit of £1 million in April 1981 and a Receiver was appointed (Financial Times, 16th April 1981, page 40). The Receiver claimed that the firm had been running up unauthorised debts by not complying with the appropriate regulations, yet the published accounts and the audit report made no mention of such matters. A writ for £1.8 million damages against the auditors, Ernst & Whinney, was issued (Financial Times, 14th February 1981). In 1984, just 10 days before the start of the court case it was reported (Financial Times, 9th June 1984, page 1) that Ernst & Whinney had agreed an out-of-court settlement of £850,000.

Successive Governments have been keen to promote the financial sector and encourage invisible exports. But a 1982 scandal shook the establishment and affected auditors.

Alexander and Alexander (an American company), following its £150 million takeover of Alexander Howden (a British broker), in accordance with the Securities Exchange Commission's requirements, had it thoroughly investigated and discovered multi-million dollar deficiencies in assets (Financial Times, 2nd September 1982, page 1). Some $55 million of the company's assets were thought to have been transferred into Panamanian companies controlled by four individuals (The Times, 24th September 1982, page 13). Further complex re-insurance frauds were also reported (The Times, 26th September 1982, page 26). Such discoveries were also to lead to the discovery of other major frauds at the PCW syndicate and covered major insurance companies such as Minet (Davison, 1987, chapter VI). In accordance with legislation, the auditors at Lloyd's are required to pay particular attention to solvency, that is the ability of the underwriters to meet their obligations. However, the asset deficiency had not been detected by the auditors. Alexander & Alexander sued the auditors for $220 million, alleging that the purchase price paid by them was influenced by the audited accounts and that they were misled[4].

In 1983, the Allied Irish Banks group bought the Insurance Corporation of Ireland (ICI) for £86 million by relying on its 1982 accounts audited by Ernst & Whinney. The accounts showed net assets of £51 million and the company also forecast a profit of £6.7 million for 1983 (The Times 28th March 1985, page 28). Subsequently it was discovered that the assets were grossly overstated. The company made losses to the tune of £99 million and the Irish government had to rescue ICI (The Times, 16th March 1985, page 19). It alleged that the accounts were false and sued Ernst & Whinney for £90 million (Accountancy, April 1985, page 7).

In February 1985, Ernst & Whinney faced a 26 page, £8.9 million lawsuit from Ruberoid alleging negligence in the 1982 audit of its newly acquired subsidiary Camrex (The Times, 19th February 1985, page 26). Ruberoid bought Camrex as a profitable business, but it showed a loss of £1.1 million in 1983 and £584,000 in 1984. Ruberoid alleged that Camrex's profits and assets for 1982 were grossly overstated and a provision of £482,800 was omitted. In addition, Camrex had been involved in a legal battle in the USA since 1977, but these facts were not known to the buyers. The Chairman of the company claimed that "Had we known what we now believe to have been the correct financial position at that time we would not have been prepared to bid at the price we did" (The Times, 16th May 1985, page 17).

In view of the continuing litigation, auditing firms were facing a severe profit squeeze. It was reported that out of a sample of 3,000 firms, 562 had faced negligence claims, frequently after the collapse of a client company. The probability of lawsuit against a firm was thought to be one out of five (Financial Times, 14th April 1986, page 5) and considered to be a major barrier to accountancy firm expansion (Financial Times, 5th August 1985, page 6). Faced with increasing uncertainty and negligence claims, in 1984, the Guardian Royal Exchange, a major insurer for accountants professional indemnity, ceased offering negligence cover

(Financial Times, 3rd April 1986, page 48). The Economist (29th June 1985) reported that lawsuits against British accountants had tripled in the last ten years. Most of these lawsuits related to liberalisation of the financial sector by the government. The Economist added that

> "the crux of the matter in most cases lies in defining the accountant's responsibility" (page 74).

The auditors' insurance costs escalated by as much as 273 percent and a ten fold increase was being forecast (Financial Times, 14th April 1986, page 21). This was against a background where Accountancy (April 1985) claimed that the

> "last 18 months have seen a flood of writs against accountants" (page 7).

Pressures on firms continued and they were keen to "stop the rot" (Accountancy, April 1985, page 7) through a test case. An opportunity to contest auditor's responsibility was taken up when Caparo Industries launched a £14 million negligence lawsuit against auditors, Touche Ross. The case involved Caparo's takeover of Fidelity. Fidelity's accounts for the year to March 1983 showed a profit of £830,000 and in July 1983 the company made a rights issue of £300,000. The circular was accompanied by a profit forecast for 1984 of £2.2 million. On 12th March 1984, in a press release, Fidelity noted its production difficulties and stated that the profit would be considerably less than the forecast figure. On 21st May 1984, Touche Ross issued an unqualified audit opinion on accounts showing a profit of £1.3 million. By relying on the accounts for the year to 31st March 1984, Caparo already a shareholder, increased its shareholding to

13.6% and by October 1984 to 92% of the issued capital. After the takeover costing nearly £14 million, Caparo allegedly discovered irregularities in Fidelity's stock valuation, arguing that the stock was worthless and obsolete. It argued that instead of showing a profit of £1.3 million, the accounts should have shown a loss of £460,000. Therefore, the accounts on which its investment decision was made were misleading. A lawsuit seeking £14 million damages for neglience against Touche Ross was issued (The Times, 22nd May 1985, page 17 and 22nd July 1985, page 17) but Touche Ross denied that they owed individual shareholders any 'duty of care'[5].

In January 1985, PRISM, the largest distributor of Sinclair Research home computers, ceased to be a going concern. It had sales of £30 million and accounted for 30% of Sinclair sales, but "due to a shortfall of contribution from its principal activities and a write-down in the value of software and modem stocks ...." it faced severe cashflow problems (Financial Times, 30th January 1985, page 30). Other problems related to product failures, marketing, legal actions and competition (Financial Times, 31st January 1985, page 6), yet the published accounts did not mention any such problems. The company issued a writ against its auditors Arthur Anderson. The three financial institutions, standing to lose about £1.2 million ,claimed to have made their investment on the strength of audited figures and were particularly concerned at the speed with which an apparently healthy company went into receivership (The Times 1st February 1985, page 10).

This section has suggested that the rising number of liquidations and negligence claims provided a major backdrop for discussions of the going concern concept in an auditing context and the formulation of the auditing guideline. Such factors were considered to be decisive in discussions of the concept (Woolf, 1985). The auditing guideline itself was meant to be a response to visible criticisms of auditors and

> "public expectation that the auditor sound alarm bell before corporate failure" (Charlesworth, 1985).

At a meeting, the Chairman of the APC working party described the guideline as

> "one of the most crucial issues currently facing the profession because the risk of litigation against firms is increasing in importance".

The next section shows that the State also exerted pressure by issuing lawsuits.

<u>6.1.5: Lawsuits from the State</u>

The lawsuits came not only from companies, but also from the State who in its capacity as a 'fraction of capital', exerted pressures for consideration of the going concern concept in an auditing context. Through lawsuits, the State officials were arguing that the auditors ought to be concerned with solvency, liquidity, financial unsoundness and matters which had a bearing on the survival of a company. An early indication was provided by claims against auditors.

For example, Deloitte Haskins and Sells made an out-of-court settlement of £150,000 to a State agency. In 1978, the National Enterprise Board (NEB) agreed to invest £180,000 in the ordinary shares and £120,000 in Power Dynamics, a company specialising in hydraulic tube and pipe bending machines (The Times, 21st February 1978, page 23). The company was formed in 1974 and used new technology to generate profits but had been experiencing severe financial problems and difficulties in securing additional finance. The NEB's investment was supposed to alleviate financial pressures and enable the company to continue to exploit its technological lead. The decision to invest was also influenced by the company's unqualified accounts showing a turnover of £60,372 and a profit of £312 for 1975 and a turnover of £196,861 and profit of £21,756 for 1976. After acquiring a one-third share of the business, NEB discovered irregularities and called in a Receiver (The Times, 3rd November 1978, page 3). Deloittes also made further enquiries in respect of the 1976 and 1977 accounts and then tried to withdraw their unqualified opinions (Accountancy, December 1978, pages 7-8). Subsequently, Deloittes agreed to make an out-of-court settlement of £150,000 to NEB (Daily Telegraph, 9th May 1979).

Another instance of State action related to the Barrow Hepburn Group, a leather and chemicals concern. This too had been operating with the NEB's financial involvement and reported a decline in its 1977 profits (The Times, 9th March 1978, page 24). The company announced that it had discovered "serious irregularities" during the winding-up of one of its subsidiaries, Schrader Mitchell and Weir (The Times, 23rd

March 1978, page 21). The irregularities within the range of £945,000 to £4.2 million occurred between 1974 and 1978 and involved concealment of losses and false book-keeping, but the accounts carried clean audit reports (The Times, 7th October 1978). The company's auditors, Mann Judd resigned by "mutual agreement" and the Fraud Squad moved in to investigate (The Times, 10th October 1978, page 17). In May 1979, it was announced that Mann Judd had agreed to pay "a substantial amount" (Daily Telegraph, 11th May 1979, page 21), estimated to be in the region of £1.5 million (Accountancy, June 1979, page 9).

By December 1981, the profession had not announced any plans[a] to issue a going concern guideline. Around this time, it was confronted with the JEB Fastners case which stated that an auditor owed a duty of care to certain third parties, even in the absence of a contractual obligation. Whilst a working party to consider the issue of the auditing guideline was formed in Spring 1982, the State continued to give visibility to auditing aspects of going concern through further legal actions against auditors. This time the legal action was against Arthur Anderson over the collapse of the DeLorean Motor Company, a company set up with State-aid by John DeLorean in Northern Ireland.

DeLorean is thought to have diverted the State funds for his personal use and into drug dealings (Fallon and Srobes, 1983). He was earning some £270,000 p.a and additional bonuses of £400,000, but the Public Accounts Committee heard that $17.5 million of the company's money went 'walkabout'

(The Accountant, 22/29 December 1983, page 682) and $8.9 million ended up as loans to DeLorean through Swiss bank accounts (The Times, 19th July 1984, page 13). The company collapsed in October 1982, resulting in a loss of 2,500 jobs and some £80 million of taxpayers money. The UK government filed a £245 million writ against auditors Arthur Anderson in the USA under the Racketeer Influenced Corrupt Organisation (RICO) legislation. The RICO laws were designed to deal with gangsters and drug dealers. The 100 page writ alleged that Arthur Anderson were negligent in failing to uncover accounting irregularities and practiced public accounting functions "fraudulently and with gross incompetence" (Sunday Times, 17th February 1985, page 1). The auditors were alleged to have "known of the irregularities but failed to bring them to the government's attentions" (Financial Times, 18th February 1985, page 6). In its defence, Arthur Anderson argued that

> "The auditor's responsibility did not include judging the viability of the project or monitoring its progress" (Financial Times, 23rd February 1985, page 3).

The government continued to take action against auditors. One of the most visible episodes related to the collapse of Johnson Matthey Bankers.

Johnson Matthey, the banking arm of a large international bullion dealer had been subject to control under the Banking Act 1979, introduced after the 1971-73 secondary banking crisis. Despite a recent record of profits, the bank had been experiencing liquidity problems (Clarke, 1986). But on 18th June 1984, auditors Arthur Young issued an unqualified audit report. On 1st October 1984, the Bank of England mounted a dramatic rescue bid (Financial Times, 2nd October 1984, page 1) and the auditor's role soon came under scrutiny. The Financial Times (2nd October 1984) argued that "the last minute rescue bid has raised serious questions about ..... faith in audited figures" (page 36). The auditing practices were further challenged when it was reported that the Bank of England had suspected the company's accounts (Financial Times, 3rd October 1984, page 6). An editorial comment (Financial Times, 3rd October 1984) asserted that the

> "....... auditors were seemingly slow to realise just how fast good money was thrown after bad ...... the process of auditing is slow ...... if one bank can vanish out of an apparently blue sky whose blueness has recently been certified by the auditors, just how dependable are the figures from the other 600-odd authorised banks?" (page 23).

MPs wondered, "why the Johnson Matthey auditors gave the bank a clean bill of health" (Financial times, 11th October 1984, page 7). The supervisory authorities argued that the auditors should have alerted the authorities of the bank's affairs, whereas Arthur Young argued that the situation had rapidly deteriorated after they signed off the last year's accounts (Financial Times, 6th October 1984, page 18). In order to protect its interests (The Times, 24th July 1985)), the government sued Arthur Young for failing to highlight the Bank's financial problems, eventually receiving £25 million in an out-of-court settlement in 1988. Commenting on the government's influence on the discussions of going concern, a partner from a major auditing firm stated that the

> "investors taking risks seem to have the impression that we are going to compensate

> them. A 'deep pockets' syndrome. This impression has to be corrected. We do not guarantee the continuation of a business. .... The directors make the 'going concern assumption', not us. An unqualified audit opinion simply means that we have not found anything to contradict the directors assertions. The government is the worst culprit ...... There is a bank not too far from here [Johnson Matthey] and the Government is suing a major firm [Arthur Young] over its collapse ...... we have to educate the public. It is just not part of the auditors job to comment on business viability and continuation. You tell me ...... have auditors ever put a company out of business ...... our insurance costs have soared beyond belief".

Soon afterwards, the issue of the going concern auditing guideline was accompanied by a comment that

> "In view of the accusing fingers which have recently been pointed at auditors in connection with certain well-publicised company failures, this guideline is a significant addition ....." (APC, 1985b, page 2).

Woolf (1985) referred to rising liquidations[7] and negligence risks as being the main motives for the auditing guideline.

This section has argued that discussions of going concern in an auditing context were considerably influenced by the actions of the State. In common with other 'fractions of capital', it took legal action against auditors and received damages. Such actions were damagaing to the economic interests of auditors and helped to concentrate attention on going concern issues. In addition, the State also acted in the long term interests of capital, including 'accountancy capital', by highlighting the shortcomings of the prevailing auditing procedures. This happened via the publication of the Department of Trade inspectors' reports, which amongst other things suggested the kind of matters to which the auditors should have paid attention, in order to detect going concern problems.

6.1.6: Critical Reports from the Department of Trade

The critical reports from the Department of Trade inspectors did two broad things. Firstly, they drew attention to deficiencies in auditing procedures which had failed to pay adequate attention to going concern problems. In this context, the reports were indicating the procedures which the auditors should have adopted. Such procedures eventually found their way into the auditing guidelines issued by the profession. Secondly, the critical reports paved the way for the formation of the Auditing Practices Committee, which was responsible for issuing the guideline.

In order to safeguard the long-term interests of capital, the State began to authorise an increasing number of investigations[8] into many corporate collapses. The resulting reports were critical of the auditors' failure to highlight going concern problems. Though a number of reports have been published (see table 6.9), this section will only focus on the few which provide a general indication (also thought to be significant by various interviewees) of the pressures. Whilst the question of auditor responsibility had not been a major political issue in recent years, by the early 1970s, the position began to change. Much of the concern began to be expressed by Departments of the State.

An early indication came with the collapse of the Pinnock Finance Group (DoT, 1971b), a business which was the result of the State sponsored expansion of the financial sector (Reid, 1982, page 24). The company was described as a "gigantic fraud in the history of private business" (Hansard, 28th May 1971, col. 773). It had accumulated losses of £2 million in 1964, £3 million on 1965 and £5.6 million in 1967. The group's manufacturing arms were insolvent and had been making losses, but kept going by falsifying its accounts and thus attracting more money. Company officials were thought to be misusing the assets. However, the company continued to receive unqualified audit opinions. At the date of its collapse, the company had liabilities of £9.2 million and assets of only £1.2 million. The inspectors concluded that the "asset figures in the balance sheets were not merely unrealistic but blatantly false" (DoT, 1971b, page 249). The auditors were described as 'tame and grossly negligent' (The Times, 27th May 1971, page 1).

The auditors were also criticised in the interim report on E.J. Austin Limited (DoT, 1972) for failing to look at the company's adverse liquidity position (page 40), excessive overdraft (page 43) and difficulty in meeting its capital commitments (page, 46). Auditors Chalmers Impey were criticised in the Pergamon Press report for too easily accepting the management's position on particular valuation and income measurements for the 1964-1968 accounts (DoT, 1973, para 625). The inspectors added "we were struck by the pattern which has emerged throughout such a period without at any point of time provoking reservations by auditors in the reports ......" (DoT, 1973, para 1244). In the wake of corporate collapses, the Department of Trade inspectors' critical comments continued to give public visibility to questions of audit procedures and auditor responsibility.

The 1975 report on Blanes Ltd and Russell Ltd was critical of the auditors' stock verififcation procedures. Auditors Thomson McLintock were criticised for their role in the collapse of Roadships Limited (DoT, 1976b). They were accused of not having paid adequate attention to profit forecasts. The firms procedures for checking creditors, accruals and purchases were found to be deficient.

In 1973, Prime Minister Edward Heath described the activities of Lonrho as the "unacceptable face of capitalism" (The Times, 7th July 1976, page 14). The resulting inspectors' report was critical of Peat Marwick and Fuller Jenks for their failure to verify directors' expenses (DoT 1976c, pages 651-652). The inspectors report on Hartley Baird (DoT, 1976d) found that the company was having difficulties in repaying its loans. However, the financial problems were covered up by manipulation of the accounts and the audit qualification was not helpful at all (page 101).

The 300 page report on the collapse of Vehicle and General, insuring some 10% of Britain's motorists, was critical of auditors Blease Lloyd (DoT, 1976e). The company did not create adequate provisions to meet insurance claims, but manipulated the financial statements to conceal the situation (page 317). The company's accounting records were defective and auditors did not spot this. For example, an investment of £82,040 was shown as £820,040 in the accounts. Some investments were ommitted altogether from the accounts. The final report on E.J. Austin (DoT, 1976f) criticised auditors for failing to spot working capital deficiencies and 'cheque swapping arrangements' entered by the company to enable it to meet its profit forecast (page 110).

Additional shortcomings of the audit procedures to highlight going concern problems came in the London and County report (DoT, 1976a), commissioned after the collapse of the secondary bank. It was highly critical of the auditors' failure (see chapter 7 for further details) to highlight the liquidity problems. In order to conceal its worsening trading position, the directors supported share purchase schemes and other illegal transactions. There were loans at less than commercial rates of interest. Bad debts were not written-off and inadequate provisions were made for the losses sustained. The accounts included income not yet earned, but the auditors gave an unqualified opinion. At the date of the collapse, the bank boasted assets of £80 million, but £10-12 million of this was due to fictitious assets. The auditors were criticised for failing to pay adequate attention to 'post balance sheet events' and for failing to note the artificial inflation of cash balances. In addition, inadequate attention was paid to the realizable value of current assets.

The auditors of Edward Wood & Company Limited were criticised for paying inadequate attention to profit forecasts (DoT, 1977a). The report on London and Capital

Group (DoT, 1977b) criticised auditors Thornton Baker for their failure to verify loans and advances to directors. The auditors of Electerminations Limited (DoT, 1978d) issued unqualified audit opinions and were criticised for paying inadequate attention to stock valuation and value of investments. During the economic crisis, attention focused on the accounts of Court Line, a major shipping and holiday company. The company's accounts had been heavily criticised in the press (see the Economist, 14th February 1976, pages 79-80 for a review) for at least three years prior to its collapse, but still attracted unqualified audit opinions. The resulting DoT report was critical of the company's accounts for 1969-73 (DoT, 1978b) and criticised Peat Marwick (for 1971 and 1972 audits) and Robson Rhodes (for the 1973 audit). The company was overgeared, facing liquidity problems for some years and had been considering selling its fixed assets to service its debt. The financial statements were found to be deficient on the account of foreign currency translations, treatment of goodwill, 'off balance sheet financing', dubious debts, unrealistic asset values and exclusion of liabilities, etc (para 549-582). Clarksons (a Court Line subsidiary) did not keep proper books of accounts for 1970 to 1973 but the auditors, Robson Rhodes, gave an unqualified report (para 716). The Group's 1973 accounts were signed off on 12th March 1974, yet the company was forecasting losses and little consideration appeared to have been given to this. Robson Rhodes were criticised for paying inadequate attention to management data, profit and cash forecasts (para 703). The auditors were further criticised for failing to pay adequate attention to the company's adverse trading conditions and ignoring their impact on liquidity in the post balance sheet period (para 7Ø5).

The auditors of Ashbourne Investments (DoT, 1979b) were criticised for failing to spot non-existent loans and false books. The 1979 report on the collapse of the Grays Building Society (Registry of Friendly Societies, 1979) made savage criticism of auditors for failing to spot a £7.1 million fraud over a period of 4Ø years. The report on Scotia Investments (DTI, 198Øa), criticised auditors Lubbock Fine for their inadequate procedures for verifying cash and bank balances (page 155); failure to note that a bank deposit of £5ØØ,ØØØ was secured and that the accounts made no mention of it and failure to pay adequate attention to back-to-back financial operations (page 174). The inspectors concluded that the auditors "fell short of the professional standard of care required from auditors" (DTI, 198Øa, page 174). Further criticisms of auditors came in the report relating to The Central Provinces Manganese Ore Company Limited, Data Investments and Vivella Limited (DTI, 198Øb). The inspectors concluded that "the auditors' report contained no qualification in relation to the acquisition or disposal of the master stakes. We conclude that the information given to the shareholders was inadequate and misleading, and that the auditors failed to seek adequate explanations regarding the transactions. As a result, they failed to qualify their report, as in our opinion, they should have done" (DTI, 198Øb, page 57). The inspectors noted that "Robson Rhodes ..... failed to carry out an adequate investigation into the circumstances in which loss had been incurred" (page 162).

The investigation into 'Gilgate Holdings (DTI, 1981b) was prompted by the filing of unsound accounts for 1975 with the Registrar and the subsequent attempts by auditors to retrieve them. The companies entered into transactions with related parties; the directors concealed liabilities and published misleading information. The inspectors criticised Thornton Baker for failing to exercise "proper professional judgement" (DTI, 1981a, para 29.37).

Peat Marwick were criticised for failing to spot liquidity problems at Orbit Holdings (DTI, 1981b) and Price Waterhouse suffered the same fate for the failure to note the financial problems at Norwest Holst (DTI, 1982). Interestingly, the DTI report commissioned on 12th September 1974 on Ramor Investments and Bryanston included a section on 'going concern' (DTI, 1983, page 243). The report was critical of Price Waterhouse but noted the impact of contemporary economic policies, property values, liquidity and bank finance on auditor consideration of going concern. An interviewee from a multinational firm described the impact of DTI reports, thus:

> "Every time a DTI report appeared, it effectively drew our attention to difficulties in spotting going concern red flags. Most of the investigations were conducted after the collapse of companies and with the benefit of hindsight. Of course, everyone is wise with the benefit of hindsight. ...... A distinct impression was created that we had a responsibility to warn people of impending failure and comment on its ability to continue as a 'going concern'. .... every time a critical DTI report appeared, it made us look foolish, we were on the front pages of newspapers, ... they increased writs, pushed up our insurance

> premiums ...... [and] made us think hard about going concern matters".

In an economically volatile environment (see section 6.2), the problems of accountancy firms were being made particularly visible by lawsuits and critical DTI reports. Such firms are identified in the next section.

6.1.7: Interests of Large Firms

The preceeding sections have referred to two highly significant developments; the lawsuits against accountancy firms (6.1.4 and 6.1.5) and the critical reports from the Department of Trade and Industry (6.1.6). In the post Hedley Byrne era, the threat of lawsuits had increased. In a period when 562 firms out of a sample of 3,000 had faced negligence law-suits (Financial times, 14th April 1986, page 5) and the number of lawsuits against auditors had tripled (The Economist, 29th June 1985, page 74), many accountants feared lasting financial damage and may have wanted the professional bodies to deal with the situation. The litigation frequently came after one of the clients failed to remain a going concern and the 'significant others' alleged that the auditor should have warned them of the impending collapse. The major firms were the visible face of the auditing woes, especially, as they frequently faced DTI criticisms and large lawsuits. For example, Arthur Anderson were involved in the DeLorean lawsuit; Peat Marwick and Touche Ross were facing a lawsuit over the collapse of Fidelity from Caparo; Arthur Young were involved in the Johnson Matthey lawsuit and criticised over the collapse of Milbury by the DTI inspectors, Robson Rhodes were criticised for their role in the collapse of Court Line; Price Waterhouse faced criticisms over the collapse of Ramor Investments. Such firms are identified in figure 6.2.

Figure 6.2

Major Firms Confronting Lawsuits and DTI Criticisms

Accountancy Firms	*Ranking Based on Fees
Coopers & Lybrand	1
Peat Marwick	2
Price Waterhouse	3
Deloitte Haskins and Sells	4
Ernst & Whinney	5
Arthur Young	6
Touche Ross	7
Thornton Baker	8
Arthur Anderson	9
Thomson McLintock	10
Pannell Kerr Forster	13
Robson Rhodes	19
Chalmers Impey	20

* As per The Accountant, 26th June 1986, page 14.

Also see Hansard 19th December 1989 col. 139 and 21st February 1990, col. 782 for identification of accountancy firms criticised by the DTI inspectors.

In view of the current and potential litigation claims, the major firms had incentives to try and take control of their environment by having favourable professional pronouncements and preferred meanings of 'going concern'. However, this could only be achieved, if despite the public criticisms of their standards of work, they could exercise control over the institutions responsible for formulating the auditing guidelines. Chapter 7 will show that such firms came to control the Auditing Practices Committee, a Committee responsible for formulating the going concern guideline. Meanwhile, the firms tried to refine their going concern audit procedures.

6.1.8: Professional Interest in Going Concern in an Auditing Context

The increased professional interest in the meanings and interpretations of the going concern concept in an auditing context coincided with the rise in litigation, corporate collapses and critical DTI reports. Whereas previously the profession argued that the auditors had no responsibility for directly reporting on corporate solvency, liquidity and the likelihood of impending bankruptcy, now the profession at least acknowledged that "it was reasonable to expect the auditor to consider the future viability of his client" (APC, 1986, page 32). Towards this end, the auditors were urged to develop appropriate auditing procedures. The Scottish Institute (ICAS, 1975) urged auditors to look at post balance sheet events, forecast of operating losses, liquidity problems, loan defaults and loss of major customers. Dunlop and Land (1975) urged auditors to focus on company forecasts and recoverability of debtor balances. Strachan (1975) urged auditors to pay particular attention to cash flow forecasts, overgearing, the company's borrowing powers, realisation of inventories, debtors and investments. Such factors also appeared in the going concern checklist issued by the AISG

(1975). Blackwood (1976) advised auditors to evaluate economic and financial indicators by focusing on ratios. In time, company cash position, history of operating losses, overgearing, etc. came to be regarded as the obvious signs of going concern problems (Campisi and Trotman, 1985).

It is also significant that the DTI reports and court cases were also suggesting the auditing procedures for dealing with going concern problems. For example, the DTI reports, such as the Court Line report were urging auditors to pay attention to overgearing, liquidity ratios, profit forecasts, cash forecasts, post balance sheet events and recoverability of debts. Burnholme and Forder mentioned the dangers of relying upon over-optimistic forecasts. The Scotia report referred to the importance of collecting evidence about the company's financial arrangements. The Gilgate report mentioned the particular importance of related party transactions. The Ramor Investments report urged the auditor to pay particular attention to the economic and market conditions surrounding the company. The Hedderwick case referred to an examination of the creditors and debtors position. Alexander Howden and Ruberoids related to valuation and verification of assets. Affairs such as Power Dynamics, highlighted the importance of profit record and financial arrangements. Barrow Hepburn referred to the importance of paying attention to a record of losses. Such auditing procedures were to become an integral part of the auditing guideline.

The senior members of the profession interviewed for this thesis were asked to cast their minds back and think about the time 'going concern' became important to them. They vividly recalled the events of the mid 1970s. Here is a typical view,

> ".... when big names such as BL, and some banks suddenly went to the wall, we smelt dangers. It wasn't just the odd John Bloom [referring to Rolls Razor] ...... Big companies were going out of existence and we were alerted .... just think of the liability problems. It was a terrible time ..... Every time a company collapsed, accountancy firms were on the front pages of newspapers. People were saying why was there no warning; why were we not informed; where were the auditors . ... there were questions in Parliament .... Of course we had to reconsider and modify our auditing procedures to identify going concern problems, but there was not much wrong with them. ..... It has never been part of our responsibility to look at business viability and neither do we guarantee its survival.
>
> .... The profession was under suspicion and hardly organised to do anything. After some banks went to the wall, we started making more use of the going concern checklists and qualification ...... I guess we hardly used this type of qualification before ....."

A senior partner from a Big-eight firm explained that

> "At the annual general meetings, the shareholders were asking questions about the impact of inflation, company liquidity, stock levels, profit margins, dividend covers, likely wage settlements and the replacement cost of fixed assets. To us, going concern concept meant paying attention to all these aspects. Historical cost accounts were not and probably still are not much use. We had to look at forecasts. It was a case of being more careful or perishing ...... ".

One Big-eight interviewee recalled a flurry of meetings of his and other firm's partners to consider going concern issues and even approaches to the professional bodies, seeking a professional pronouncement. Another interviewee from an international firm (which has subsequently been strongly represented on the Auditing Practices Committee) recalled that in view of the deepening economic crisis, a memorandum was prepared to brief all partners and managers on the question of 'auditor and going concern'. A copy of this, is shown in Appendix 5. A number of features should be noted. It makes clear references to factors causing a liquidity crisis: such as high interest rates, over borrowing, high commodity prices, declining property values and falling rates of profitability. It includes a checklist for making going concern evaluations and expects auditors to consider future oriented information such as forecasts. The newness of the topic is suggested by words such as, "Is it [the company] a going concern? Now necessary to determine answer to this on each and every occasion for all clients" (see para 2.2 of Appendix 5).

The accountancy firms paid attention to going concern problems, but the implications for auditor responsibility still remained somewhat unclear. Such issues were to be dealt with in the auditing guideline in 1985 and will be examined in chapter 7.

6.1.9: A Connective Summary and Discussion

This section argued that discussions of the going concern concept in an auditing context became widespread in the 1970s, mainly due to a combination of certain elements. For a considerable time, the meaning of an audit and the nature of auditor responsibilities had been contested. However, the

1970s saw an important change. The Hedley Byrne case indicated that auditors may owe a 'duty of care' to third parties, even in the absence of any contractual obligations. This possibility occurred against a background of falling rates of profitability, liquidity ratios and an increasing rate of corporate insolvencies. During such an economic climate, the auditing procedures were frequently seen to be deficient by 'significant others'. The State, a prime sponsor of the monopolies and privileges of the accountancy profession was transmitting such messages through the DTI inspectors' reports. The increasing scrutiny of auditing procedures, auditor responsibility and the damage done to accountancy firm profits by the large number of lawsuits, forced the profession to devote more and more attention to discussions of the going concern concept. Such pressures also threatened the legitimacy of the profession and the functions it performs for the reproduction of capital. In such an environment, the profession was forced to develop a strategy for dealing with such pressures, eventually leading to the issue of an auditing guideline in August 1985.

The DTI reports highlighted deficiencies in auditing procedures and indicated the steps the auditors ought to take to satisfy themselves that a business is a going concern. It is also important to note that many of the publicly reported lawsuits and the DTI criticisms were levelled against major firms such as Arthur Anderson, Touche Ross, Peat Marwick, Price Waterhouse, Arthur Young and others. In an attempt to protect their economic interests, such firms had economic incentives to play a significant role in the formulation of the auditing guideline.

The next section refers to the social, economic and political developments which created conditions for widspread discussions and emergence of the concept in an auditing context.

6.2: SOCIAL, ECONOMIC AND POLITICAL CONTEXTS 1970s-1985

The discussions of going concern in an auditing context occurred within the space created by the economic, political and social developments. The discussions arose in the context of what the Accountants International Study Group (1975) called a "volatile economic environment" (para 5) and the ICAS (1975) argued that the "present economic climate is causing the position to be less obvious" (page 141). Strachan (1975) also argued that the "economic conditions in the United Kingdom ..... cause many companies and their auditors to consider the validity of the "going concern" concept in relation to the financial accounts" (page 66). This section now examines a number of related events and episodes which provided a backdrop for the increasing attention being paid to the going concern concept in an auditing context. These relate to attempts to revive the ailing British economy (6.2.1), a property and secondary banking collapse (6.2.2), continuing decline of the economy (6.2.3), and the policies of the 'New Right' which adopted a particular way of managing the British economy (6.2.4).

6.2.1: Reviving the British Economy in the Early 1970s

Relatively low investment (table 6.10) in the British industry has been blamed for slow rejuvenation of the post-war British economy and successive Governments have pursued economic policies to change this. Historically, British industrial capital has been less dependent on the banks for finance and more reliant on internal sources for investment. For example, between 1950 and 1972, 76% of gross capital formation in Britain was funded from earnings compared to 62% in Germany and 49% in France. When seeking long term finance, the British industry favoured equity rather than debt and the banks generally provided short-term loans (Coakley and Harris, 1983). Such preferences were seen as barriers to industrial development and the Heath Government decided to relax the monetary policies.

In March 1971, the Bank of England announced its proposals for 'Competition and Credit Control' to replace the previously restrictive credit policy (Bank of England Quarterly Bulletin, June 1971). Under this, the banks' liquidity ratios were to be reduced and competition was to be encouraged. Following the Chancellor's budget speech of April 1971, the government engineered a mini-boom by ending credit ceilings for banks and hire-purchase companies, which allowed them to lend more freely. The financial sector was one of the few rapidly expanding areas of the economy and the government was keen to lure international banks to London and promote it as an international financial centre (Clarke, 1986). This expansion of the financial sector was to be accompanied by a "less formal system of supervision" (Reid, 1982, page 4). In 1972, Sterling was also floated to prevent any constraints on domestic expansion (Smith, 1981, page 80). At the same time, the government was using the public sector to reflate the economy. For example, between 1970 and 1972, public sector expenditure increased by more than 8% in real terms (Thomson, 1986, page 317).

In this climate, the banks began lending money in new and novel ways to many secondary banks (Moran, 1984; Clarke, 1986). However, the government aspirations and policies had contradictory effects. Since the late 1960s, the government had been keen to move businesses to unemployment blackspots and was making it difficult to build new office blocks in London, especially the City of London. Special permits were needed for office development. The office space was effectively being rationed, but at the same time, the government was encouraging foreign banks and financial institutions to come to London. Property prices and rents in and around London began to increase. Office rents in the City of London rose fourfold between 1965 and 1970 (Moran, 1984) and in anticipation of new tenants and high rents, lots of new office blocks sprung up on the fringes of the City of London. Whilst the average profitability of the British economy was declining (table 6.5), the returns on property looked very attractive and many banks were lending money for such ventures through new practices.

The economic measures were politically designed to reduce unemployment and revitalise the economy, but the effects were complex. Increased bank competition and money supply pushed up demand and inflation. Imports flooded in, partcularly of cars and consumer durables and British jobs disappeared at a faster rate. The main reason, according to the Wilson Committee was that

> "there was less rebuilding after the war than in many continental countries, with the result that more of Britain's factories are in old and unsuitable buildings than elsewhere, even if machines in them may not be appreciably older than in other countries. British industry has not adopted new technology to the same degree as industry in other countries. ...... Britain's industrial mix is poorer than that of many developed competitiors. In engineering, for example, more of Britain's industrial machinery exports are in relatively standard items, less in high value-added, high technology items" (Wilson, 1980, page 128).

Excessive cash, fierce competition and low investment soon resulted in double figure inflation and unemployment started to increase sharply (Lisle-Williams, 1986). Increased competition and lending in an expansionary environment vastly increased bank lending, not so much to the British manufacturing Industry, but rather much more to speculative ventures (Coakley and Harris, 1983). Much of the newly released bank finance went to the property sector, whose borrowings, despite the Bank of England's restraining measures, trebled between 1971 and 1973 (Grady and Weale, 1986, page 148) and reached an estimated figure of £5,000 million by the end of 1973. Some £1,300 million of the speculative money to the property sector was provided by the main clearing banks, who between May 1972 and 1973 increased their advances to property companies by 70%. The property boom in the main was fuelled by loans from the secondary banks who borrowed short and lent long, with loans being secured against the property itself in an ever rising market. The secondary banks provided nearly £1,400 million to property companies and some £2,000 million to other financial borrowers (Reid, 1982, page 61). Easy money, credit and over optimism caused the commercial property prices to treble between 1970 and 1973 and the price of new houses rose by around 50% between 1972 and 1973 (Moran, 1984).

The period leading to the break-up of the Bretton Woods system on 19th March 1973 also increased financial uncertainty and attracted more than a fair share of speculative money to the City of London, by now one of the world's major international financial centres. The international currency status of Sterling led to a run on Sterling in 1972 and the first half of 1973 was marked by an almost continuous international currency crisis (Bank of England Quarterly Bulletin, June 1973, page 127). The economic uncertainty led to a rush to buy gold and the London gold price rose two and half times between early 1972 and mid 1973. Speculative buying also pushed up the property and commodity prices and this, combined with other factors, soon gave the appearance of a serious economic crisis in Britain (Armstrong, Glyn and Harrison, 1984, chapter 12). In the face of a deteriorating industrial performance and import penetration, unemployment had already begun to increase.

In an attempt to control the situation, the Heath Government now sought to cut demand (Bank of England Quarterly Bulletin, September 1973, page 271), inhibit competition and credit by imposing a supplementary special deposit scheme on all banks (Bank of England Quarterly Bulletin, 1974). As a part of this strategy, the banks were required to make non-interest bearing deposits with the Bank of England amounting to as much as 4% of their total eligible liabilities (Bank of England Quarterly Bulletin, July 1973, page 269). In an attempt to control inflation, the Government imposed controls on prices and income and a freeze on all business rents, thus further worsening the rates of profitability.

In July 1973, the government sought to curb demand for money by hoisting the bank lending rate from 7.75% to 11.5% and then to a record 13% in November. At the same time it imposed a new development gains tax on property speculation. Suddenly, the property values started to appear highly uncertain. The inflation rate (see table 6.2), under the spell of rising commodity prices and imports, was pushed up even higher and became a major government policy issue (Bank of England Quarterly, June 1973). By 1973, 53% of the energy of the western world was supplied by oil (Green and Sutcliffe, 1987, page 324) and the increased demand had already caused the oil prices to accelerate (Bank of England Quarterly, June 1973). A further jolt came in the wake of the October 1973 Arab-Israeli conflict. The price of oil rose from $2 to $11 a barrel (Green and Sutcliffe, 1987; page 326), adding some $4-$4.5 billion to the British import bill and increased the industrial costs by 2-3% (Bank of England Quarterly Bulletin, March 1974, page 3). Such a sudden increase in costs further fuelled the inflationary fires in Britain and affected its ability to export. Unemployment and bankruptcies began to increase. This, combined with the impact of a 'three day week' caused by the miners' strike, increased pressures on the British economy and the rate of profitability continued to decline (see table 6.5). Such a decline was considered to be threat to investment, business survival and confidence (Financial Times, 27th June 1973, page 22). It was further argued that "a continuing drop in the return on investment, whatever its cause, would raise serious doubts about the stability of what is loosely described as the capitalist system" (Financial Times, 4th July 1973, page 22). Faced with low return on investment, companies such as Courtaulds and GEC took to arbitraging in the money markets rather than investing in their manufacturing capacity. The prospects for the British economy and its secondary producers looked bleak. To boost the falling rate of profitability, the government increased grants, capital allowances and other tax reliefs to industry, resulting in a drastic reduction in the effective rate of corporate taxation on profits from a 1970 figure of 40% to the 1973 figure of 11% (Armstrong, Glyn and Harrison 1984, page 258). Despite the concern with falling business liquidity (see table 6.6), in an attempt to control inflation, the government deflated the economy by cutting public expenditure by £1,200 million (Bank of England Quarterly Bulletin, March 1974, page 3).

Such contradictory policies were to have serious consequences.

6.2.2: Property and Banking Collapse in the Mid 1970s

The government economic policies, a continuing fall in the rate of profit, a global economic crisis and London's place as an international financial centre, led to some highly visible events in Britain. The immediate result was to intensify the competition for money, with some companies and banks paying way over the odds to secure cash (Moran, 1984, page 82). This was eventually to feed into a crash in the property values and a subsequent secondary banking crisis (Reid, 1982; Coakley and Harris, 1983; McRae and Cairncross, 1985). Almost the first British secondary bank to collapse was London and County Securities[9] . Just before its collapse, the bank had published good half-year profits but these turned out to be 'illusory' and misleading (Moran, 1984). In view of the financial squeeze, the bank was unable to secure additional finance and depositors from the wholesale money markets quickly withdrew their deposits. By 29th November 1973, its share price plummeted from a 1973 high of 400p to a low of 30p and its shares were suspended. The government launched an investigation into its sudden collapse and the resulting DoT report found that 36% of the company's deposits were payable within one month and 43% within three months, yet almost all of the bank's assets, consisting of property and loans were highly illiquid (DoT, 1976a). The published accounts and the audit report gave no clue of such a situation [10]. Confidence saving rescue attempts were launched by the Bank of England. The interdependence of banks and the impact of economic crisis set-off a domino effect. The position was made worst by the fact that banks were unable to borrow to service the debt and the lenders, having sequestrated the property assets, could not sell them. A liquidity crisis set in.

In November 1973, Moorgate Mercantile boasting paper assets of £50 million, but almost completely illiquid, went into liquidation. December 1973 saw suspension of the shares in Cedar Holdings[11], another secondary bank. This bank once again borrowed short and lent in the medium-term second mortgage market, but was now unable to meet its obligations. The share price dropped from a high of 90p to 15p and dealings were suspended. Barclays Bank mounted a rescue operation of £80 million (Grady and Weale, 1986, page 151). Around the same time the National Westminster Bank mounted a £14 million rescue of Twentieth Century Banking.

Cornhill Consolidated Group, a discount house backed by a number of financial institutions, built up its capital employed from £35,000 to £20 million in less than five years by offering generous rates to depositors and using the money for a wide variety of activities (DTI, 1980c). During August 1973, whilst borrowing at 27.5% and 30%, it was unable to borrow more from the secondary banks and service its debts and finally failed in January 1974. The company had regular audits and trading losses of £5 million, but failed to file any accounts with the Registrar of companies from August 1970 to December 1973. The company was described as "no more than a huge speculation with borrowed money" (Financial Times, 17th December 1981, page 6). Window dressing was rampant in the company's accounts and the inspectors concluded that such accounts "did not show a true and fair view" (page 258). However, Price Waterhouse had given an unqualified audit opinion on all of them (DTI, 1980c).

The crisis soon affected many other banks and financial institutions, especially as the major banks and insurance companies owned as much as a quarter of the equity of leading secondary banks (Coakley and Harris, 1983, page 71). The State had to bail out the troubled banks. Between December 1973 and March 1974, 21 institutions were assisted at a cost of about £400 million (Grady and Weale, 1986, page 151). The list of well established companies and institutions needing State-aid continued to lengthen. In April 1974, Triumph Investment Trust and J.H. Vavasseur were aided. The Lyon Property Group faced a liquidity crisis in May 1974 and was assisted. In June 1974, the Stern Property Group consisting of nearly 180 companies collapsed and four years later its director William Stern was declared the world's biggest bankrupt owing £118,690,524 and earned an entry in the Guiness Book of Records (Aris, 1985, page 66). In anticipation of rising property values, the group continued to borrow and the banks and Crown Agents (a State agency) continued to accept such assets as securities. The group was extremely overgeared, with interest payments alone totalling some £23 million, now reaching three times its total income. Subsequently, some of the group's buildings were sold at only 40% and some sites at only 20% of their previous values (Reid, 1982, page 106). The failure affected its bankers Keyser Ullman who were kept afloat by an injection of £65 million by the Bank of England. Crown Agents had also been speculating and was exposed by the collapse of secondary banks and property values (Grady and Weale, 1986, page 167). In Decmber 1974, it also received financial assistance of £85 million and in view of the political sensitivity of issues, a three man team, led by a chartered accountant Peter Godfrey, was asked to conduct an investigation. The First National Finance Corporation (backed by Phoenix Assurance Company, Hambros Bank, Crown Agents and the Electricity Supply Pension Fund) brought in to rescue London and County, itself had to be rescued. By August 1974, the aid given to banks was estimated to have reached £1,200 million (Grady and Weale, 1986). At one stage, even the National Westminster Bank was rumoured to be in financial trouble and its chairman had to issue a public denial to restore confidence in the Bank (Moran, 1984).

In January 1975, the Bank of England also came to the rescue of Slater Walker Limited (SWL), a division of Slater Walker Securities. The bank had given very large loans to relatively few clients. Four of its largest loans ranged from £5 million to £18 million and accounted for 51% of the bank's portfolio and 16 loans of over £1 million accounted for 31% of the portfolio. In total, it gave 150 loans, but only 13% of these accounted for 82% of the total value of its portfolio. It had liabilities of £57 million payable within three months and assets available to meet them of only £22 million. Its banking activities were in breach of its Articles of Association. In October 1975, the Bank of England gave the SWL subsidiary a secured standby facility to help it meet the rush of withdrawals from private investors. In November 1975, this facility was estimated to be £75 million. By an agreement reached on 11th December 1975, the Bank of England indemnified SWL and its banking subsidiaries against losses on advances to the tune of £40 million. Another bank, Edward Bates was saved by Arab money (Grady and Weale, 1986, page 152). Institutions such as Mercantile Credit, British Bangladesh Trust, United Dominions Trust, Crown Agents and many others were badly affected by the falling property values and ill-judged speculation and were rescued by State assistance. The shares in Scotia Investments, a leisure giant with considerable development property, collapsed in November 1975 and on 11th February 1976, a DTI inquiry team was appointed. The falling property values and rising interest rates created liquidity problems for the company (DTI, 1980a). The company continued to sell assets to stay alive yet the accounts continued to show unrealistic asset values. The financial position was manipulated and the auditors paid inadequate attention to cash and bank balances (page 155). Company assets were pledged to secure personal loans, but the auditors continued to give unqualified opinions (page 174).

The State restored some order in the secondary banking and property sector by spending an estimated £3,000 million on rescues (Reid, 1982, page 192), and this does not include any interest and capital repayments written off. The mechanisms for regulating banks and industry were seen to be deficient and in the search for solutions, the Department of Trade authorised a record number of investigations, 158 in 1974 and 177 in 1975 (see table 6.9) and enacted new legislation[12]. Many of the published DTI reports (table 6.9) were also critical of the role of auditors who had failed to act in the long-term interests of 'capital'. The secondary banking crisis curtailed the speculative boom and restored some measure of balance between the financial and real economy. It also resulted in a management shake-out and an enforced restructuring of the British financial sector and industry, a process which also enabled some to buy assets at knockdown prices, indulge in asset stripping and affect employment and liquidations levels in all sectors of the economy.

6.2.3: Continuing Decline of the Economy in the Mid-1970s

After some unsuccessful attempts, Britain finally joined the European Economic Community (EEC) on 1st January 1973. The ailing British industry with falling profitability (table 6.5) and low investment, was now to be subjected to much more extensive European competition by a significant reduction in import tarriffs. In 1974, the incoming Labour Government inherited an unemployment total of 600,000 and pursued mildly expansionary policies to tackle it. But, under the influence of rising commodity prices rather than wages, the rate of inflation reached 16.1% and the government imposed prices, income and dividends controls in order to manage the economic crisis. Profit margins were not allowed to rise above a certain figure based on an average of the two preceeding years and thus further squeezed profit margins and borrowings increased. Companies borrowed more and around 1974, the British companies' gearing ratios reached their highest ever level (Barclays Bank Review, May 1982). To provide additional funds for investment and reduce pressures on liquidity, the government further reduced the taxation burden on industry by about £800 million by granting 'stock relief', a measure designed to exempt paper gains from taxation (Bank of England Quarterly Bulletin, December 1974, page 397). But, the British industry's rate of profitability continued to decline (see table 6.5). The additional money did not find its way into industrial investment, instead many major companies used the finance to play the money markets in an effort to earn higher profits.

The companies staying in the manufacturing field were buffeted by low profitability, fierce competition and lack of finance and investment. Between 1973 and 1976, industrial production in Britain fell by 8%. The plight of the British industry is perhaps typified by the fortunes of British Leyland Motor Corporation Limited (BLMC), a company brought about by mergers and active policies of the State (Dunnett, 1980). The market share of this giant multi-national, continued to decline from 40% in 1968 to 32% in 1974, a situation not helped by the recent government engineered mini-booms which sucked in imports and eroded its market position. In view of the implications for employment, balance of payments and exports, the government was keen to maintain and promote the BLMC as a major volume car manufacturer. In July 1974, BLMC unveiled a five year investment programme, designed to help it recover its markets, but the bankers refused to make the necessary funds available and the company's ability to remain a going concern was in doubt. On 6th December 1974, the Secretary of State for Industry announced that the government was effectively underwriting all loans to BLMC. Eventually, BL was nationalised on 11th August 1975 (Williams, Williams and Haslam, 1987). Motor car import penetration also threatened the manufacture of cars by other established companies in Britain. In October 1975, the American owned Chrysler company also threatened to shut its operations and with it damage the prospects for employment and the dependent industries. In December 1975, a government committed to promoting British manufacture of cars and helping the BLMC, had to rescue one of its major competitors, Chrysler.

Another candidate for State support was the Burmah Oil Company. This winner of the 1973 'The Accountant award for best annual report' with extensive interests in Britain's new found oil wealth in the North Sea, had been raising money overseas to avoid the high British interest rates and investing in huge new tankers. Following the oil price rise, it was having financial difficulties in meeting its $650 million debt obligations and in November 1974 sought State assistance (The Times, 2nd January 1975, page 13). In view of the company's strategic role in North Sea oil exploitation, the Bank of England agreed to provide appropriate credit lines and in January 1975 bought a 21% stake in the company, increasing it to 51% in April 1975.

Spectacular company crashes such as the Court Line collapse hit press headlines. The Court line group consisted of 100 companies specialising in North sea oil, shipping, leisure, leasing and holidays and included such household names as Horizon and Clarksons holidays. Faced with a massive rise in fuel costs, declining property values and demand for its products and services, it went into liquidation in August 1974, leaving 40,000 stranded holidaymakers. The State quickly intervened and bought off the Sunderland and Devon shipyards to safeguard jobs and on 21st July 1975, appointed inspectors to investigate the sudden demise of this group (DoT, 1978b). The once invincible companies were collapsing and ceasing to be going concerns. This at a time when major industrial concerns such as Rolls Royce[13] , Harland and Wolff, Upper Clyde Shipbuilders, Ferranti and others were being rescued and the State was also struggling with the secondary banking crisis. In 1975, the government responded by establishing a National Enterprise Board (NEB), not only to nurse some companies, but also to promote regional policies, industrial reorganisation and invest in profitable projects.

In 1975, control of inflation, rather than unemployment, became the main government policy (Dunnett, 1980), but inflation continued to rise and in 1975 it hit a record 24.9%. The general loss of confidence in the British economy sent the Financial Times index plummeting to an all time low of 146 in early January 1975. The British industry's rate of profit sank to almost 3.9% before tax (Green and Sutcliffe, 1987, page 302). The number of compulsory liquidations rose sharply (table 6.5). The government policies, pressures from the City and international markets could not halt the decline of the British economy. In order to manage the 'economic crisis' and related legitimacy crisis for the State, the government had to seek financial assistance ($3.9 billion) from the International Monetary Fund (IMF) and accept its punitive conditions. It was forced to implement a £2.5 billion deflationary package. This resulted in public expenditure cuts, reductions in demand and consumption and an increase in unemployment. The economic crisis affected Sterling, by now a petro-currency. At the beginning of 1976 it was worth two dollars, but in October 1976 it plummeted to £1= $1.55. Interest rates rocketed from the March figure of 9% to 15% in October. The rate of profit for British industry for 1974-77 barely equalled 5.5% p.a. (Clark and Williams, 1978). The number of liquidations now reached a record 10,727 (table 6.7) and the Department of Trade continued to authorise a high number of investigations into corporate collapses and irregularities (table 6.9). These now also included the building societies. In 1976, the Wakefield Building Society collapsed, soon to be followed in 1978 by the Grays Building Society, where the Chairman had been carrying out a systematic fraud totalling some £7.1 million over the last 40 years (Boleat, 1982). The auditors had given an unqualified audit report for each of the years. The resulting report (Registrar of Friendly Societies, 1979) was highly critical of auditors for their failure to spot simple errors and frauds and accused them of performing the audit in an undemanding manner .

6.2.4: Policies of the 'New Right' in the Late 1970s and early 1980s

1979 witnessed the further rise of the 'New Right'[14] and the election of the Conservative Party under the leadership of Margaret Thatcher. In the field of local government, education, law and order, it was highly interventionist, but in the field of economics it claimed to be geared towards deregulation (or more correctly regulation by the markets), privatisation, cutting subsidies, curbing restrictive trade union practices and generally rolling back the state. Inflation had been rising, spurred on by a new oil price increase, from $13 a barrel to $35 a barrel in 1981 (Green and Sutcliffe, 1987). Upon coming to office, the government abandoned exchange controls. Britain's top 200 major companies took advantage of this and established operations in low cost overseas countries (OECD, 1983, pages 18-20), thus increasing pressures on the British economy. The abandonment of exchange controls also made the banks more diversified and they ventured into many other countries, particularly the developing nations and in the process loosened their reliance on revenue from the British industry.

In accordance with the monetarist philosophies, the Thatcher Government immediately reduced the support for nationalised industries from the 1979-80 figure of £2.3 billion to minus £400 million in 1983-84. Grants to local authorities were cut by 3.5% in real terms (Armstrong, Glyn and Harrison, 1984, page 410). In times of recession, the private sector frequently relied upon the public sector to purchase its goods and services. This trade was estimated to be some £10 billion per annum (Open University, 1983), but this valuable support was now declining. By 1981, the level of British manufacturing output was barely equal to that of 1967. Between 1979 and March 1981, the output of British factories fell by 17% and unemployment doubled from 1.2 million to over

2 million. With the disappearance of subsidies, the industrial costs rose and pressures for efficiency and rationalisation increased. Real wages and consumer spending power continued to fall and markets shrank.

The British manufacturing industry's rate of return declined to 2% in the last quarter of 1980 (Bank of England Quarterly, June 1981, page 161), soon hitting an all time low of 1.7% (Green and Sutcliffe, 1987, page 302), and barely started to pick up again in 1982 (Bank of England Quarterly Bulletin, June 1983). In the face of low profits and lack of investment, capital markets became stagnant and in 1982, the debt market virtually collapsed (Samuels and Wilkes, 1986, chapter 6). The economic situation was summed up by an OECD report, which noted that the downturn

> "was considerably stronger in the UK than elsewhere in the OECD area, real GDP declined by about 5 per cent in the three years to mid-1982 compared with a rise of 2 per cent in the OECD area as a whole. The loss of output and employment in manufacturing has been particularly severe and there has been a considerable contraction of the industrial base" (OECD, February 1983, page 7).

Between 1979 and 1983, some £25 billion of industrial investment had been written-off as scrap (Bryer and Brignall, 1986). Despite its monetarist ideology, the Government still had to bail out some ailing businesses. For example, ICL, the British flagship in the computer industry with 18% of the home market, had been suffering trading problems since 1979 and had to be saved with a State-aid of £210 million (The Times, 20th March 1981, pages 1 and 19). It also provided additional funds to DeLorean Motor Company. As indicated previously, this company was originally set up in 1978 in Belfast with £54 million of State-aid. Its objective was to manufacture 30,000 cars and create 2,500 jobs in Belfast. By 1980, the Thatcher Government injected a further £24 million into the ailing business (Fallon and Srodes, 1983, page 275).

British industry continued to use ageing plant and equipment. By 1982, the industrial investment in Britain had fallen back to the level of 1965 (OECD, February 1983, pages 44-45). These factors resulted in further loss of competitiveness, loss of markets, poor returns and a further disincentive to invest. In order to boost demand, direct taxation was reduced, but the British industry was unable to meet increased demand on the consumers' terms (OECD, February 1983, page 37). The government used the interest rates to regulate the economy; raising them from a negative 5% to a high of positive 9% in real terms (see table 6.4).

Despite the high interest rates, the British businesses increased their reliance on banks for short and medium term finance. The banks provided as much as 80% of the short and medium term finance for businesses. In times of distress, the banks, up to a point, were willing to nurse and give special care to companies. The Barclays Bank claimed to have 600 corporate clients of various sizes on its 'sick list' (Coakley and Harris, 1983). In 1982, the major banks set aside £962 million to cover bad debts and were showing increased willingness to take appropriate steps to recover their loans. For the period 1970-74, the major banks appointed receivers to about 150 companies on average. For the first 10 months of 1980, the figure was 400, but as Aris (1985) notes, in 1982 Barclays alone placed some 618 companies in liquidation and Midlands was not far behind with 510. Liquidations of some well known companies hit the headlines. Stone-Platt, an engineering company with declining profits defaulted on its gearing covenants and having been kept alive by its bankers was finally put into receivership in March 1982. The entire British toy industry led by Airfix, Dumbee Combex and Marx, Lesney and Berwick Timpo was put into liquidation by the banks. Laker Airways was laid to rest by Midland and twenty other banks. This collapse became a spectacular media event, as the banks exercised the charges over the assets by confiscating the jets in mid-air and forcing them to return to their departing airports. The collapse caught everyone on the hop as Laker's profits had been rising from the 1976 figure of £900,000 to £8.1 million in 1980. In financial circles, overgearing, touching a debt-equity ratio of 5:1, was cited as the main reason for its collapse (Financial Times, 6th February 1982). Lee (1984) argued that ordinary accounting with its emphasis on profits concealed the cash flow and liquidity problems. In January 1982, DeLorean Motor Company established with State-aid by John DeLorean was experiencing a cash shortage of $50 million. For the financial year 1981, it experienced a loss of £23.1 million and crashed (Fallon and Srodes, 1983, page 380). However, the accounts audited by Arthur Anders~~o~~en carried an unqualified audit opinion. Faced with increased costs and competition, the number of bankrupticies increased dramatically (see table 6.5); moving from the 1979 figure of 9,090 to 16,893 in 1982.

Following the mid 1970s secondary banking crisis, a new Banking Act was passed in 1979. Much of the regulation was now on an informal basis, itself a part of wider crisis management mechanisms introduced to manage the continuing crisis of capitalism. This was soon to be tested by the Johnson Matthey affair and raise shadows of the earlier crisis. The Johnson Matthey empire consisted of two broad parts (Clarke, 1986), one relating to interests in chemicals, technology, jewellery, precious metals, etc. and the second relating to merchant banking. Johnson Matthey, in its capacity as a precious metal dealer, had membership of the prestigious and highly lucrative London Gold Ring which at its twice-daily meetings fixed gold prices for the world market. The merchant banking arm, Johnson Matthey Bankers (JMB) ran into difficulties in October 1984. A major cause of the crash was attributed to loans to third world countries (the result of earlier government policies) who were having difficulty in repaying them. At the time of the crash, African loans stood at £450 million. JMB had also lent monies to two groups of companies operating from Pakistan. Each of these loans amounted to more than 10% of its capital and further advances continued. By June 1983, the loans stood at 26% and 17% respectively of the capital. By December 1983, they represented 51% and 25% of its capital and by June 1984, the figures reached 76% and 39% respectively. Up to half of the JMB's portfolio consisted of doubtful debts and losses were estimated to be £250 million. Under the Banking Act 1979, loans exceeding 10% of the issued capital were supposed to be notified to the supervisory authorities, but this had not been done either by the company or its auditors. The published accounts gave no indication of financial problems. The bank was overgeared and under-capitalised, but auditors Arthur Young issued an unqualified audit report. Johnson Matthey lost its entire £102 million investment in JMB and had to make available another £50 million to rescue its ailing arm. Many clearing banks were unwilling to rescue a small, and what they regarded as an imprudent secondary bank. The Bank of England eventually had to rescue JMB. This provided a field day in Parliament for the critics who cited the Government's refusal to rescue other ailing industries and pointed to its willingness to use public money to bail out 'finance capital' (Clarke, 1984, page 46). The Bank of England Governor indicated that JMB was rescued because of the likely impact on the Gold Ring, fearing that the downfall of one member could cause the demise of the whole Ring and could have precipitated into a major economic crisis. Having nursed the bank, the government quietly sold its stake to the private sector in 1985. In late 1984, the Government set up a new Committee to revise the Banking Act 1979. This Committee made 34 recommendations which resulted in the 1987 Banking Act[15].

6.2.5: Section Summary

Discussions of going concern in an auditing context did not arise in an empty space. Such discussions arose against a background of economic, political and social developments. This section has drawn attention to a number of interconnected episodes from this period. Whilst some inflation, exchange rate fluctuations, unemployment and liquidations are essential elements of capitalism, the period reviewed here differed in that it went through structural adjustments to enable the system to survive. High unemployment, high interest rates, high liquidations, the rise of the financial sector and decline of the manufacturing base, import penetration and Britain becoming a net importer of manufactured goods for the first time in its history are all indicators of structural adjustments. Whilst much of the crisis also had an international dimension, the British State tried to manage it by contradictory policies involving reflation/deflation of economy, devaluation/revalutaion of exchange rates, tax cuts/increases, public expenditure cuts/increases and by controlling money supply. To cope with the crisis, the State also enacted new legislation, for example, the Banking Acts and undertook a very high number of investigations into British business practices, usually after they had ceased to be going concerns. Such investigations focused upon competing meanings of an audit and highlighted deficiencies in auditing practices.

It is against such a background that the accountancy profession started devoting more attention to discussions of 'going concern' in an auditing context.

6.3: CHAPTER SUMMARY AND DISCUSSION

Chapter 3 noted that references to 'going concern' in an auditing context were relatively scarce prior to the 1970s and that after this period references to it became widespread. Upon becoming aware of this development, the present chapter began with a question: Why did the discussions of 'auditor and going concern' take off in this period? The remainder of this chapter then set out to provide an answer within the theoretical framework specified in chapter 2.

The 'motor' of the discusssions is provided by the economic developments since the 1970s. The period from the 1970s to 1985 is noted for the end of the 'long boom', 'stagnation' and a massive restructuring of the British economy resulting in mass unemployment, falling profit rates, increasing liquidations, inflation, interest rates, the decline of Britain's manufacturing base and the rise of the financial sector. The massive restructuring of the period described in the first part ensured that many 'going concerns' just ceased to be going anywhere. In this climate, the profession was insisting that 'going concern', its 'generally accepted' and a 'fundamental' principle of accounting implied that the enterprise will continue in operational existence for the forseeable future. An unqualified audit opinion continued to suggest that the going concern assumption was appropriate.

The economic developments came at a time when the very meaning of audit was being contested. In view of the developments in the finance and capital markets, the courts widened the auditors' traditional area of liability. Whenever a business with an unqualified audit opinion ceased its operations, attention focused on the legitimacy of the audit opinion. Some 'significant others' argued that the auditor should have paid attention to corporate solvency, liquidity and survival. It is noticeable that discussions of 'going concern' were almost always accompanied by mention of rising litigation, corporate collapses and the views of 'significant others' (e.g. the State).

The views of 'significant others' were backed by lawsuits and critical DTI reports. Such antagonisms gave prominence to one of the meanings of the concept. In banking circles, at least since the early part of twentieth century, the concept has been taken to mean "an undertaking which is in full working order" (a 1921 banking dictionary quoted in Strachan, 1975). Despite arguing that the auditor is not responsible for reporting on corporate solvency and survival, the profession now made concessions. It sought to regain mastery of its environment by arguing that "it was reasonable to expect the auditor to consider the future viability of his client" (APC, 1986, page 32).

The State played an important role. Firstly, it acted in the long term interests of capital by urging auditors (through DTI reports) to devote a particular kind of attention to detecting going concern problems. This would have enhanced confidence in the published financial information and also enabled the 'accountancy capital' to transform and reproduce itself. The recommended auditing procedures had a contemporary flavour about them. For example, in an environment of a liquidity crisis, the auditor was expected to pay attention to liquidity and cash shortage. Following the Court Line and Laker Airways collapse, spotting 'overgearing' became an accepted auditing procedure. Financing arrangements, bank letters and overdrafts became the focus of attention following the Scotia Investments collapse. The above implications were being popularised by institutions such as the Accountants' International Study Group, the Institute of Chartered Accountants of Scotland and others. Such audit procedures eventually found their way into going concern auditing guideline (APC, 1985a). Secondly, in its capacity as a 'fraction of capital', the State sued accountancy firms for failure to perform appropriate procedures to highlight doubts about the ability of some concerns to survive. Its actions highlighted the inadequacies of auditing procedures and thus created opportunities for the firms to be socially responsive and efficient. The DTI reports were also cited by plaintiffs as evidence in court action against auditors.

Historically, the going concern concept has been linked with discussions of valuation bases. Some writers have used the concept to justify a need for cash flow accounting, current cost accounting, constant purchasing power accounting, exit values and others, but in the auditing context such debates were not very prominent. Neither the DTI reports, nor the litigants, made any direct reference to such valuation bases in their arguments. The auditing discussions of the concept arose at a time when there was considerable debate about price level accounting (Whittington, 1983) and State concern about the variety of price level accounting (Sandilands, 1975), but in this context there was no direct linkage between the accounting and auditing meanings of the concept.

It is as though the meanings of the concept were following a somewhat separate path in accounting and auditing. In an auditing context, it seemed to be more influenced by the contemporary developments relating to auditor liability, responsibility and litigation.

The chapter noted that in the aftermath of a corporate collapse, many large and powerful firms faced lawsuits. These included firms such as Arthur Andersen, Arthur Young, Coopers & Lybrand, Touche Ross, Ernst & Whinney, Deloittes, Peat Marwick, Robson Rhodes and others. The lawsuits were damaging to the economic interests of accountancy firms. Payment of damages and resulting high insurance costs threatened their profit generating ability. Such firms had incentives to seek protection of their position by shaping the further institutional developments and meanings of the concept. Perhaps, they might be keen to find ways of protecting themselves from lawsuits through the issue of auditing guidelines. This could be done if they were in a position to control the institution (Auditing Practices Committee) responsible for formulating the auditing guidelines. Their interests could be furthered if they could control the agenda and the related issues. Therefore, the next chapter will examine the development of the going concern guideline, the nature of the Auditing Practices Committee and the role played by major firms in formulating the guideline.

Chapter 6 Footnotes

1) The meaning of what is a structural change, is widely debated by social scientists and is open to theoretical interpretation. A minimal definition would relate to fundamental changes in the way an economy has hitherto been organised. Thus major upheavals and dislocations occur.

2) Auditing issues do not come neatly packaged and 'going concern' is no exception. It is a part of the wider debates relating to the expectations gap, auditor responsibility, liability, duties and social obligations.

3) The views are attributed to an ICAEW Deputy President by Strachan (1975, page 68).

4) In November 1986, it was reported that an out-of-court settlement of $24 million has been reached between the company and its auditors with Arthur Young paying $14.2 million), Peat Marwick paying $4.8 million) and de Paula Turner Lake paying $5 million (Accountancy Age, 13th November 1986, page 1).

5) The case subsequently went to the House of Lords, where in 1990 it was decided that an auditor did not owe a 'duty of care' to any shareholder in his capacity as an 'individual shareholder'.

6) In December 1981, Accountancy (page 20) published APC's work-in-progress, but this did not include any reference to 'going concern'.

7) Increase in bankruptcies provided, investigation work from the banks (The Accountant, 6th May 1982, page 620) and income for the insolvency divisions of accountancy firms, yet it also posed a threat to the auditing arm of accountancy firms.

8) Just to put it into perspective, the average number of annual investigations authorised in 1950s and 1960s was one or two per annum and did not exceed 10 until 1967 (Accountancy, October 1982, page 15). However, as table 6.9 shows, the figures have rocketed since the 1970s.

9) London and County Securities was backed by the National Westminster Bank, Eagle Star Insurance Company and Keyser Ullman.

10) The DTI report on the London and County affair was highly significant for the profession. Some aspects are discussed in chapter 7.

11) Cedar Holdings was backed by Phoenix Assurance, Unilever, pensions funds of the National Coal Board and the Electricity Industry.

12) The secondary banking crisis led to a revamping of the Banking regulation and the enactment of the Banking Act 1979.

13) For details of the Rolls Royce story, see Deeson (1972).

14) A good discussion of the policies preferred by the 'New Right' will be found in Bosanquet (1983) and Hall and Jacques (1983).

15) The Act swept aside the auditor's concern with the confidentiality of information and now explicitly requires them to report matters relating to a bank's liquidity, incompetence and fraud to supervisory authorities, without the knowledge of their clients. However, equivalent requirements are not enshrined in the Companies Acts and are thus not applicable to ordinary limited companies.

TABLE 6.1

UK BALANCE OF TRADE (AS % of GDP)

Period	a) Manufacturers Products	b) Primary Products
1966-70	+4.9	-5.7
1971-75	+3.5	-6.2
1976-80	+3.2	-4.6
1981-82	+1.6	-0.4
1983	-0.5	+0.3
1984	-1.1	-0.3
1985	-0.7	+0.1
1986	-1.3	-0.9

a) Sales of manufactured items minus imports.

b) Net imports of primary products (e.g. food, industrial raw materials).

Source: Annual Abstract of Statistics, 1988 edition and earlier.

TABLE 6.2

GENERAL INDEX OF PRICES (percentage increase per year)

Year	Annual Rate
1967	2.5%
1968	4.7%
1969	5.4%
1970	6.4%
1971	9.4%
1972	7.1%
1973	9.2%
1974	16.1%
1975	24.9%
1976	16.5%
1977	15.8%
1978	10.8%
1979	13.4%
1980	18.0%
1981	11.9%
1982	8.6%
1983	4.6%
1984	5.0%
1985	6.1%
1986	3.4%

Source: Annual Abstract of Statistics (1988 Edition).

TABLE 6.3

NOMINAL INTEREST RATES IN THE UK

Date	Rate
April 1970	7%
April 1971	6%
September 1971	5%
June 1972	6%
October 1972	7.50%
December 1972	9%
January 1973	8.75%
March 1973	8.50%
April 1973	8.25%
May 1973	8%
May 1973	7.75%
June 1973	7.5%
July 1973	11.5%
October 1973	11.25%
November 1973	13%
January 1974	12.75%
February 1974	12.75%
February 1974	12.5%
April 1974	12.25%
April 1974	12%
May 1974	11.75%
September 1974	11.50%
January 1975	11.25%
January 1975	11%
February 1975	10.75%
February 1975	10.50%
March 1975	10.25%
March 1975	10%
April 1975	9.75%
May 1975	10%
July 1975	11%
October 1975	12%
November 1975	11.75%
November 1975	11.50%
December 1975	11.25%
January 1976	11%
January 1976	10.75%
January 1976	10.50%
January 1976	10%
February 1976	9.50%
February 1976	9.25%
March 1976	9%
April 1976	10.50%
May 1976	11.50%
September 1976	13%
October 1976	15%
November 1976	14.75%
December 1976	14.50%
December 1976	14.25%
January 1977	14%
January 1977	13.25%
January 1977	12.25%
February 1977	12%

March 1977	11%
March 1977	10.50%
March 1977	9.50%
April 1977	9.25%
April 1977	9%
April 1977	8.75%
April 1977	8.25%
May 1977	8%
August 1977	7.50%
August 1977	7%
September 1977	6%
October 1977	5.50%
October 1977	5%
November 1977	7%
January 1978	6.50%
April 1978	7.50%
May 1978	8.75%
May 1978	9%
June 1978	10%
November 1978	12.50%
February 1979	14%
March 1979	13%
April 1979	12%
June 1979	14%
November 1979	17%
July 1980	16%
November 1980	14%
March 1981	12%
August 1981	13.50%
September 1981	14.50%
November 1981	16%
January 1982	15.5%
April 1982	14.5%
March 1982	15%
June 1982	14%
July 1982	13.5%
September 1982	12%
October 1982	11.50%
November 1982	10.50%
December 1982	10%
February 1983	11%
March 1983	11.50%
May 1983	11%
June 1983	10.50%
August 1983	10%
November 1983	9%
June 1984	9.50%
August 1984	10.5%
October 1984	11%
November 1984	11.25%
January 1985	10%
March 1985	13%
April 1985	14%
November 1985	12%

Sources:

Bank of England Quarterly Bulletins (Various issues).
Barclays Bank Reviews (Various issues).
Midland Bank Reviews (Various issues).

Table 6.4

REAL INTEREST RATES IN THE UK

YEAR	RATE
1967	- 5.50%
1968	- 2.3%
1969	+ 2.6%
1970	- 0.6%
1971	- 4.4%
1972	+ 1.9%
1973	- 3.8%
1974	- 4.60%
1975	-13.65%
1976	- 1.50%
1977	- 8.80%
1978	+ 1.70%
1979	+ 3.60%
1980	- 4.00%
1981	+ 4.10%
1982	+ 1.40%
1983	+ 4.40%
1984	+ 6.25%
1985	+ 7.9%
1986	+ 8.60%

Source:

Derived from the nominal interest rates and the general index of prices tables.

Table 6.5

Rates of return before interest and tax at current replacement cost

Industrial and commercial companies and manufacturing companies based on national accounts data

Per cent

Year	All industrial and commercial companies		Industrial and commercial companies excluding North Sea [1]		Manufacturing companies	
	Gross (a)	Net (b)	Gross (a)	Net (b)	Gross (a)	Net (b)
1960	11.8	13.7	11.8	13.7	12.2	14.8
1961	10.6	11.7	10.6	11.7	10.6	12.3
1962	9.9	10.7	9.9	10.7	9.8	11.1
1963	10.4	11.5	10.4	11.5	10.2	11.7
1964	10.9	12.2	10.9	12.2	10.5	12.1
1965	10.5	11.5	10.5	11.5	10.0	11.2
1966	9.6	10.1	9.6	10.2	9.0	9.7
1967	9.6	10.2	9.7	10.3	9.1	9.8
1968	9.7	10.3	9.8	10.4	8.9	9.5
1969	9.7	10.1	9.8	10.2	9.1	9.8
1970	8.9	8.9	8.9	8.9	8.0	8.1
1971	9.1	9.1	9.1	9.2	7.3	6.9
1972	9.3	9.5	9.3	9.5	8.0	8.1
1973	8.8	8.9	8.8	8.9	7.8	8.0
1974	6.2	5.1	6.3	5.3	5.3	4.3
1975	5.5	3.9	5.6	4.2	4.4	2.8
1976	5.9	4.3	5.7	4.3	4.7	3.2
1977	8.0	7.4	7.4	6.7	6.4	5.7
1978	8.4	7.8	7.7	7.1	6.5	6.0
1979	8.0	7.4	6.6	5.6	5.4	4.3
1980	7.4	6.3	5.4	3.8	4.7	3.0
1981	7.3	6.1	4.8	2.8	4.2	2.3
1982	8.3	7.7	5.6	4.0	5.2	4.0
1983	9.3	9.3	6.2	4.9	5.5	4.4
1984	10.1	10.7	6.6	5.6	5.9	5.1
1985	10.7	11.5	7.8	7.2	6.6	6.4
1986	9.7	10.0	8.8	8.9	7.3	7.5
1987	10.5	11.3	9.6	10.2	8.3	9.2

1 North Sea exploration and production activities.

Basis of estimates

Profits	Capital employed
(a) Gross operating surplus on UK operations, ie gross trading profits less stock appreciation plus rent received.	(a) Gross capital stock of fixed assets (excluding land) at current replacement cost, plus book value of stocks, in UK.
(b) Net operating surplus on UK operations, ie gross operating surplus less capital consumption at current replacement cost.	(b) Net capital stock of fixed assets (excluding land) and current replacement cost, plus book value of stocks, in UK.

Note: The above figures are not strictly speaking comparable as numrous adjustments have been made by recent governments.

There are also numerous theoretical and conceptual difficulties in computing rates of return. Some of these are summarised in Armstrong, Glynn and Harrison (1984).

Source: British Business, September 1988, page 32.

Table 6.6

* Liquidity Ratios of British Companies

Year	All Survey Cos.	Manufacturing Cos.	Non Manufacturing Cos.
1970			
1st Qtr	64	41	146
2nd Qtr	56	36	128
3rd Qtr	53	36	112
4th Qtr	52	36	112
1971			
1st Qtr	50	34	106
2nd Qtr	58	42	109
3rd Qtr	67	51	108
4th Qtr	80	66	110
1972			
1st Qtr	90	79	111
2nd Qtr	103	96	114
3rd Qtr	105	102	111
4th Qtr	111	108	115
1973			
1st Qtr	113	122	101
2nd Qtr	110	119	97
3rd Qtr	110	114	106
4th Qtr	98	94	104
1974			
1st Qtr	83	74	99
2nd Qtr	71	49	107
3rd Qtr	59	39	95
4th Qtr	52	34	86
1975			
1st Qtr	58	38	92
2nd Qtr	66	51	91
3rd Qtr	75	63	93
4th Qtr	84	75	95
1976			
1st Qtr	91	87	97
2nd Qtr	89	92	85
3rd Qtr	96	104	86
4th Qtr	89	95	80
1977			
1st Qtr	101	105	95
2nd Qtr	98	106	86
3rd Qtr	104	112	90
4th Qtr	119	119	118
1978			
1st Qtr	139	136	144
2nd Qtr	144	134	163

3rd Qtr	133	118	165
4th Qtr	127	121	139
<u>1979</u>			
1st Qtr	110	102	125
2nd Qtr	110	110	110
3rd Qtr	100	97	104
4th Qtr	79	71	93
<u>1980</u>			
1st Qtr	74	71	80
2nd Qtr	73	63	96
3rd Qtr	72	65	87
4th Qtr	82	69	108
<u>1981</u>			
1st Qtr	78	72	91
2nd Qtr	88	80	103
3rd Qtr	98	94	106
4th Qtr	91	87	99
<u>1982</u>			
1st Qtr	88	89	87
2nd Qtr	83	90	70
3rd Qtr	71	71	69
4th Qtr	82	86	76
<u>1983</u>			
1st Qtr	98	105	87
2nd Qtr	106	107	103
3rd Qtr	124	125	122
4th Qtr	119	118	122
<u>1984</u>			
1st Qtr	115	105	126
2nd Qtr	107	94	122
3rd Qtr	109	91	132
4th Qtr	102	79	132
<u>1985</u>			
1st Qtr	91	67	125
2nd Qtr	96	69	134
3rd Qtr	97	65	142
4th Qtr	98	72	133

<u>* Notes:</u>

1) Liquidity ratios = total current assets as percentage of total current liabilities.

2) Figures are not strictly comparable as numerous adjustments have been made by government departments.

3) This table should only be regarded as giving a broad indication of the liquidity problems faced by British businesses.

<u>Sources:</u> British Business, 10th September 1982, page 35; 30th November 1984, page 569; 28th November 1986, page 35.

Table 6.7

Yearly Total of Liquidations in the UK

YEAR	Compulsory liquidations	Voluntary liquidations		Total
		Creditors	Members	
1970	1,337	2,568	4,939	8,844
1971	1,206	2,481	4,802	8,489
1972	1,189	2,056	5,022	8,267
1973	1,108	1,580	4,598	7,286
1974	1,438	2,450	4,039	7,927
1975	2,343	3,277	4,229	9,849
1976	2,602	3,615	4,510	10,727
1977	2,493	3,641	3,914	10,048
1978	2,351	3,062	3,881	9,294
1979	2,127	2,682	4,281	9,090
1980	3,078	4,265	4,251	11,594
1981	2,945	6,188	3,925	13,058
1982	3,932	8,759	4,202	16,893
1983	5,085	8,953	4,103	18,141
1984	5,551	8,776	4,066	18,393
1985	6,103	9,443	4,248	19,794
1986	5,559	9,521	4,833	19,913

Sources Department of Trade and Industry Annual Abstract of Statistics, 1988 editions and earlier.

Table 6.8

UNEMPLOYMENT IN THE UK

Year	Numbers (ØØØ's)
1967	5Ø3
1968	542
1969	518
197Ø	555
1971	724
1972	8Ø4
1973	575
1974	542
1975	866
1976	1,332
1977	1,359
1978	1,343
1979	1,235
198Ø	1,513
1981	2,395
1982	2,77Ø
1983	2,984
1984	3,Ø3Ø
1985	3,179
1986	3,229

Source: Central Statistical Office, 'Annual Abstract of Statistics', 1989 Edition and earlier.

TABLE 6.9

Department of Trade Inspectors' Reports Reports

Year	Investigtions Authorised	Reports Published
1970	76	Nil
1971	117	2
1972	115	2
1973	93	2
1974	158	2
1975	177	6
1976	152	8
1977	115	3
1978	101	6
1979	79	7
1980	81	7
1981	103	9
1982	91	2
1983	112	1
1984	101	1
1985	116	1

Sources: Annual Reports published by the Department of Trade and Industry.

Table 6.10

Manufacturing Industry - Investment per Worker 1963-1972

	United Kingdom	United States	Japan	France	West Germany	Italy	Netherlands	Luxembourg	Belgium	Denmark	Eire
1963	122	330	183	283	214	184	229	—	222	217	159
1964	138	385	202	304	230	156	283	—	229	253	162
1965	153	444	163	318	256	131	298	—	261	284	198
1966	166	503	191	346	257	150	347	—	307	273	204
1967	167	534	288	372	247	173	376	—	321	297	211
1968	181	599	402	440	278	221	445	—	339	271	264
1969	209	652	502	497	372	251	474	—	386	347	320
1970	239	687	555	569	490	308	623	—	484	—	358
1971	272	713	513	623	521	339	675	—	508	—	—
1972	273	759	599	—	537	364	703	—	—	—	—

Source: Trade and Industry, 21st November 1974.

CHAPTER 7

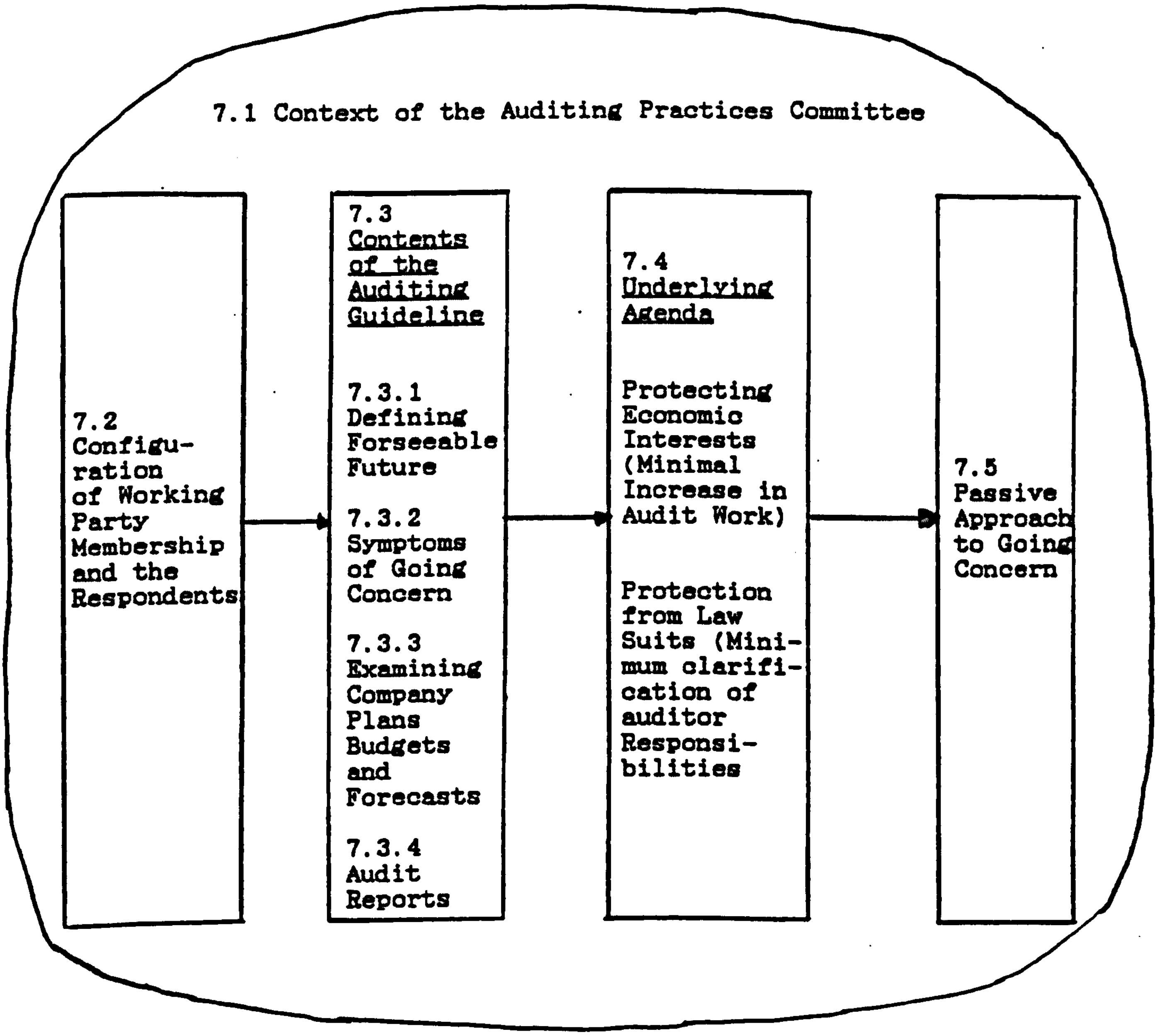
UNDERSTANDING THE AUDITING GUIDELINE, 'THE AUDITOR'S CONSIDERATIONS IN RESPECT OF GOING CONCERN'

7.Ø: Introduction

This chapter continues to provide further sociopolitical explanations of the meanings attached to the 'going concern' concept in an auditing context. The 197Øs began with an increased interest in the going concern in an auditing context. Chapter 6 explained the economic, social and political developments which provided a cradle for the discussions of the concept in an auditing context. The heightened institutional interest eventually led to the issuance of an auditing guideline 'The auditor's considerations in respect of going concern' by the Auditing Practices Committee (APC) in August 1985. The guideline (APC, 1985a) was summarised in Chapter 3 (see page 15Ø).

This chapter will now explain the manner in which the profession came to formulate the auditing guideline. This requires an awareness of the institutions which formulated the guideline, the parties which participated and the 'interests' which shaped the meanings. This chapter will focus on such aspects. In order to do so, this chapter is divided into five main parts. An overview is provided by figure 7.1. The first section (7.1) will examine some aspects of the formation and development of the APC which prepared the guideline.

Figure 7.1
An Overview of the Chapter



Section 7.2 to 7.5 focuses on the development of the meanings which the APC assigned to the concept. The main thrust to identify the 'interests' being promoted through the meanings of the concept. Section 7.2 looks at the APC's consultative process (7.2.1) and the identity of the parties who responded (7.2.2) to the going concern exposure draft.

After a section summary (7.2.3), the next section (7.3) examines the details of the guideline. Much of the guideline is concerned with discussions of the forseeable future (7.3.1), symptoms of going concern problems (7.3.2), advising auditors to examine company plans, budgets and forecasts (7.3.3) and the wording of audit reports (7.3.4). This section aims to ascertain the 'interests' which have shaped the details of the guideline. Section 7.3.5 summarises the section. Section 7.3 reveals that the profession had an underlying agenda in developing the guideline. Section 7.4 examines this. It is found that in the main, the profession was concerned with protecting the economic interests of the auditing firms and using the meanings incorporated in the going concern guideline to protect the auditing firms from law-suits. The final section (7.5) shows that in order to protect the interests of the auditing firms, the profession deliberately recommended a 'passive' approach to evaluating going concern issues as this legitimises minimal audit effort. Section 7.6 concludes the chapter with a discussion and a summary.

7.1: THE CONTEXT OF THE AUDITING PRACTICES COMMITTEE

The meanings of the going concern concept cannot be understood without knowledge of the institutions which shape such meanings. The institutions represent the collective interests of some groups and are a powerful influence in defining what is legitimate or acceptable. In keeping with such views, this section examines the formation and development of the Auditing Practices Committee (APC), an institution responsible for formulating the going concern auditing guideline in 1985[1]. This section, as figure 7.2 shows, is divided into five parts.

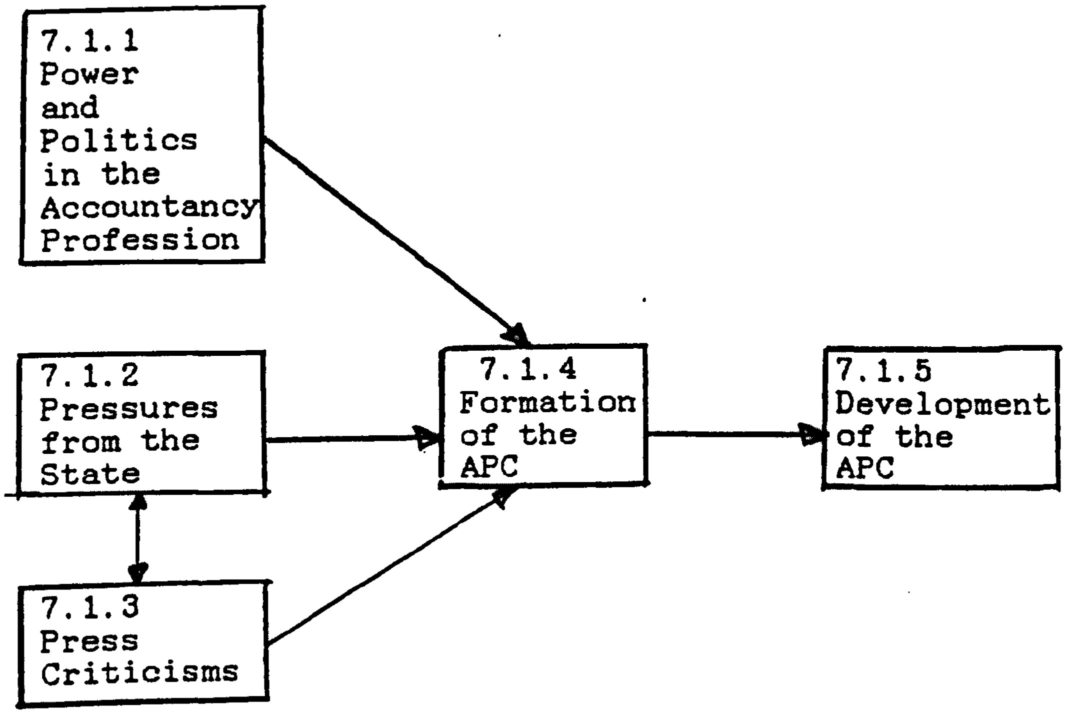


Figure 7.2
Understanding the Context of the APC

The 'interests' shaping the guideline can be understood by focusing upon power and politics within the accountancy profession, pressures from the State and press criticisms of the auditing practices. Such developments paved the way for the formation and the development of the APC. It will be argued that since its formation, the APC has been dominated by major firms who have been the subject of lawsuits and public criticisms and further that a major aim of the APC has been to promote the economic interests of major firms.

7.1.1: Politics and Power in the Accountancy Profession

The formation of the Auditing Practices Committee (APC) is shaped by the power and politics within the accountancy profession in which auditing and auditors have always been privileged and claim to be the inheritors and protectors of professionalism.

Auditing firms are a major source of training and ideological grounding for a vast majority of the UK accountants. Most UK accountants not only study auditing, but also at some stage of their career have practiced auditing. The language of the UK accountancy profession suggests that the auditing wing is not only privileged but it also exercises significant influence on the whole of the accountancy profession. The phrase 'entering the profession' is almost exclusively used when someone joins an accountancy firm and very rarely used when an accountant joins an industrial or a commercial concern. Historically, accountants training outside the accountancy firms have been considered to be almost second class (Dickinson, 1902). Bromwich (1985, page 22) notes that the non-practising accountants were not allowed to serve on the ICAEW Council until 1942. Stamp and Moonitz (1979, page 64) note that to become a Fellow of the ICAEW, the experience requirements were either 5 years with the accountancy firms or 10 years outside the public practice. In recent years, the auditing wing of the profession has continued to have a considerably disproportionate representation on the Councils of the major professional bodies. For example, only round 22% of the membership of the Chartered Association of Certified Accountants is in public practice, yet according to its Royal Charter, 50% of the Council membership must come from the auditing wing. Much of the current professional regulatory framework also appears to be designed with the practising wing in mind[2]. All in all, the auditing wing is highly privileged and powerful and this forms a significant backdrop to an understanding of the emergence of the APC.

Auditing practices have been examined by the State (e.g. through the Department of Trade reports) and the accountancy profession (for example, through the 'U' series of Statements, issued between 1961 and 1977). However, such developments did not result in the creation of a professional regulatory body specific to auditing. A turning point was the formation of the Accounting Standards Steering Committee (ASSC) in 1969[3]. The State sponsored mergers and the resulting concentration of capital within the forces of capitalism provided the particular site for a public examination of accounting and the auditors' role in providing what might be called, 'official explanations' and legitimation of corporate practices. For example, in one of the mergers involving GEC and AEI, the financial information produced by AEI had been approved by a leading accountancy firm, Deloittes Plender and Griffiths. The subsequent takeover of AEI by GEC cast doubts on the validity of such information and made the subjective and discretionary nature of accounting publicly visible. This was soon to be followed by the Pergamon affair, involving the unsuccessful merger between Pergamon and Leasco. In this case Price Waterhouse and Chalmers Impey were pitched against each other and attested to vastly different figures from the same data. Such episodes occurred at the time when the ICAEW, had a full programme of issuing 'Recommendations on Accounting Principles' and 'Statements on Auditing'. In this context, The Economist (9th August 1969, page 58) accused auditors of passively accepting management's accounts and explanations. On 30th August, 1969, it accused auditors of not believing "in any written rules" (page 43). It added that

> "playing the game is all very well and most accountants do. But the system which has been exposed so lamentably this week in the City's handling of the mess-up simply is not good enough" (page 44).

The Observer (31st August 1969) noted,

> "A simple soul might reckon that you can not have two independent experts coming up with different profit figures from the same set of accounts; he would be wrong".

The Guardian (22nd October 1969, page 15), whilst referring to the Pergamon Press affair criticised the auditor's role in being passive and concluded,

> "........ unless steps are taken to restore faith in our auditing firms by ensuring that they really do act as shareholders' watchdogs, a major row will break which will do the accounting profession lasting damage" (page 15).

Such episodes made not only the accounting problems visible, but also drew attention to the nature of auditing practices. In his celebrated article (The Times, 11th September 1969, page 25), Professor Stamp, an influential academic was critical of the auditing practices. In his reply (The Times, 22nd September 1969, page 25), Mr. (later Sir) Ronald Leach, the 1969-70 ICAEW President and a Peat Marwick partner, rejected Stamp's charges against auditors and instead referred to the judgemental nature of accounting only. Although the criticisms related to accounting and auditing practices, the crisis was mediated by the creation of the ASSC to regulate accounting practices, initially under the control of the practising wing but subsequently allowing other accountants to join in. The ICAEW's 'Statement of Intent' (ICAEW, 1969) spoke of the need to narrow accounting choices and improving acounting standards. Despite being central to the credibility of published annual accounts, the auditing aspects did not get any mention in this document. The auditing aspects were clearly made to appear secondary. The auditing wing went on to shape the accounting standards by giving prominence to its 'sectional interests'. So great has been the power of the practising wing that most of the accounting standards have continued to pronounce

> "...... what is convenient for auditors to audit rather than what is most useful for those for whom the information is intended" (Briston, 1981, page 59).

Such developments whilst indicating domination and control of the profession, are also indicative of the political skills of the leaders of the profession in linking the profession's crisis of legitimacy not with auditing, but with accounting. Overall, the role of auditing in the crisis was obfuscated and an equivalent Committee to regulate auditing was not created.

The pre-occupation with accounting standards suggested that the legitimation problems were caused by the preparers of financial statements rather than the flexibilities permitted by auditors. By the mid 1970s, the accounting standards programme was proceeding under the control of the auditing wing, but the auditing deficiencies continued to be highlighted by the critical DoT reports and press reports. Such developments constrained the profession's ability to blame accounting laxities alone for a crisis of confidence in external financial reporting. The profession had recently (i.e. early 1970s) played its accounting card and in the next publicly visible crisis of financial reporting, 'the divide and rule' strategy would be blunted. In the mid 1970s crisis, a different card, relating to auditing, needed to be played. This crisis was to be mediated by the creation of the APC under the total control of the auditing wing, even though almost all sections of a society are affected to some degree by auditing policies. The pressures to play this card were taking shape in the context of massive social, economic and political changes and the resulting scrutiny, especially by the State, of the unsatisfactory nature of auditing practices.

7.1.2: Pressures from the State

Criticisms of auditing practices continued to appear, especially as the auditors are privvy to 'inside information' and enjoy a statutory monopoly of the external audit function. In return, the auditors are expected to give an honest opinion on the accounts. However, there was a strong feeling that

> "the auditors knew far more than their reports actually disclosed" (Woolf 1986a, page 511).

These suspicions were frequently fuelled by the DoT/DTI reports which in the wake of scandals and corporate collapses scrutinised auditing practices and found them to be deficient (also see chapter 6). Such criticisms created conditions for the formation of the Auditing Practices Committee.

After the publication of the critical report relating to the collapse of the Pinnock Finance Group (DoT, 1971b), the Secretary of State came under pressure and stated that he

> "must rely upon auditors to satisfy themselves as to the value of assets shown in company balance sheets. ...... These events raise important questions. .... The Government are not satisfied on either of these matters, and I intend to discuss them with the professional bodies concerned in the near future, with a view to possible action". (Hansard, 28th May 1971, col. 773-787).

Further pressures continued to come in the aftermath of increasing corporate collapses. The standards of auditing continued to be criticised in the reports relating to E.J. Austin (DoT, 1972) Pergamon Press (DoT, 1973), Roadships (DoT, 1976b), Lonrho (DoT, 1976c) and Vehicle and General (DoT, 1976e) amongst others. A major concern with the auditing practices arose in the aftermath of the secondary banking crisis and the related collapse in the property market (see chapter 6 for more details). The collapse of the London and County Securities is regarded as a 'crisis point' for the profession (Davison, 1976; Hopkins, 1980). The episode also attracted particular public attention, as the then leader of the Liberal Party, Jeremy Thorpe was a non-executive director of this bank. Significantly, London and Counties (L&C) had recently been audited by Harmood Banner[4], in which David Richards (who was to become the first APC Chairman) was a partner.

The Department of Trade report (DoT 1976a) noted that in order to conceal its worsening trading position and prospects, the bank since 1972 had been supporting its share price by entering into illegal transactions involving directors and their families. The inspectors concluded that the loans were not in the ordinary course of trade and contravened the Companies Act 1948. In addition, the bank entered into 'bed and breakfast' transactions, sometimes recording false transactions. For example, just before the year-end, one of the bank's subsidiaries took in a loan of £14 million from the money market and repaid it within the first week of the new financial year, enabling the bank to improve its ratios. The parent company also took another £7 million overnight from the money markets and gave it to its subsidiary. Such transactions were entered into with the support of other institutions. Winstrust (another secondary bank) audited by Spicer & Pegler placed £4 million with L&C only four days before its year-end and L&C straight away deposited £2.5 million back with Wintrust who helped to finance the purchase of L&C's shares. Such arrangements helped to improve the company's liquidity ratio of cash to deposits from 13% to 43%. At the date of its collapse, L&C boasted deposits of £80 million or so, but £10-12 million was due to fictitious transactions. The inspectors concluded that

"the auditors should not have signed the

> unqualified audit report on the accounts ....at 31st March 1972. The main extent of inflation of the cash balances was known to the audit partner .... and it was so serious as to make the accounts misleading to a material extent. .... Some at least of the ways in which this was done should have been apparent had the audit work been more penetrating and effective. The accounts for 1973 were unsatisfactory and misleading." (page 234).

Questions about the role of auditors were also raised in the House of Commons. On 9th February 1976, responding to an observation that one of the, "...... worst features of the affair ...... is the fact that the auditors passed the accounts of this organisation", the Secretary of State for Trade and Industry said that he would

> "certainly consider much more carefully the whole role of auditors in this matter" (Hansard, Vol. 904/905, Issue no 1024, pages 10-11).

Throughout the L&C and other previous investigations, the number of meetings between DTI senior civil servants and the leaders of the profession increased. The Ministers also regularly met senior figures from the profession to express concerns about audit failures. The junior Ministers at the DTI were spending as much as 25%-30% of their time dealing with the fallout from the criticisms of accounting and auditing practices and hearing concerns aired by some company directors and institutional investors. Such criticisms posed a serious threat to the legitimacy of corporate disclosures and with it the workings of the already seriously weakened finance and capital markets. This at a time when the government was already struggling to introduce some order to the financial sector (see chapter 6).

The DoT seriously considered the creation of an independent body to promulgate auditing standards and to take action against accountancy firms criticised in the inspectors' reports. However, in view of the deep economic crisis, the overstretched State had little capacity to either set up a new regulatory body or to take lengthy legal action against accountancy firms. The DTI was already involved in managing a record number of corporate investigations and was fully occupied with rescuing major companies and dealing with the property and secondary banking crisis. The government was particularly concerned with restoring confidence in the financial and insurance sectors, major earners of foreign revenues. In the aftermath of the 1973 oil crisis, inflation and unemployment were sharply rising and Britain was still reeling from the effects of the miner's strike and the three day week. With falling profitability and investment, the DoT was devoting its attention to a revival of the British economy by devising regional grants, subsidies and reliefs. The government was operating a prices and incomes policy and was considering approaching the International Monetary Fund (IMF) for loans. In such circumstances, the announcement of any new public expenditure on the creation of a new regulatory body was considered to be politically undesirable. Within the DTI, there was also a strong belief that by directly becoming involved in auditing, the Department may become implicated in the crisis and thus create further problems for the government. The age old ideology that auditing is best regulated by the assumed 'experts' also carried a strong weight. What the Investors Chronicle (27th

February 1976) called "behind the scenes education and conciliation" (page 564) followed. In the final analysis, a statutory body to regulate auditing was not set up, but a consensus for the need for a Committee to promulgate auditing standards was established.

Further pressures from the government continued. In the autumn of 1976, Presidents of the four Institutes permitted to carry out statutory company audits (ICAEW, ICAS, ICAI and CACA) were summoned to jointly see the Secretary of State for Trade and a wide and frank discussion took place. A former Secretary of State for Trade explained[5] that he

> "was certainly concerned about the failings of the accountancy profession and made them very well aware of my concerns. Their failings were brought home in the successive reports .... I told representatives of the profession that either they regulated themselves effectively or I would ask Parliament to do it for them. But, irrespective of the action they themselves then took, there would not have been Parliamentary time for legislation".

The Ministers themselves were being pushed by backbench MPs. Indeed, an attempt was made by Ivor Clemitson (MP for Luton East) to introduce a public board for regulating auditors, but on a 'free vote', his proposals were defeated by 35 votes (Hansard, 22nd March 1977, cols. 1081-1088). In behind the scenes discussions, the Ministers were frequently placating MPs by referring to the agenda for reform which was being ushered in by the critical reports of the inspectors.

These reports were critical of the standards of auditing and related to companies such as the London and Capital Group

Limited (DoT, 1977b), Edward Wood & Company Limited (DoT, 1977d), Electerminations Limited (DoT, 1978), Court Line (DoT, 1978b), Burnholme and Forder (DTI, 1979a), Peachey Property Corporation (DoT, 1979c), Ashbourne Investments (DoT, 1979b), Grays Building Society, (Registry of Friendly Societies, 1979), Scotia Investments' auditors (DTI, 1980a), Gilgate Properties (DTI, 1981c), Orbit Holdings (DTI, 1981b), Norwest Holst (DTI, 1982) and Ramor Investments (DTI, 1983). The general drift of such reports was known to the profession throughh two channels. Firstly, through the regular meetings with senior servants and the government Ministers and secondly, through the senior figures within the profession who had been acting as inspectors for the Department of Trade[6]. From their very special positions, such individuals were in a position to alert the profession of the dangers ahead. For Woolf (1983), most of the auditing crisis was due to

> "the ease with which eminent firms of auditors turned a blind eye on the wholesale abuse by client company directors of [legal] provisions. [The directors] operated these public companies for the principal benefit of themselves and their families; and most regrettable of all, on the virtual complicity of their auditors, whose efforts are seen to have amounted to a whitewash at best, and a fatuous charade at worst" (Woolf, 1983a, page 112).

The DoT reports were critical of the major firms and the prevailing professional standards in particular. Such a crisis of confidence could only be managed by creating new institutions. In case the profession was not convinced, the prevailing press opinion provided a foretaste.

7.1.3: Press Criticisms

By the late 1960s, spurred by the State sponsored merger booms and the increasing importance of finance and capital markets, the wider press had begun to take a greater interest in accounting and auditing matters (Zeff, 1972). It criticised contemporary auditing practices. For example, the Daily Telegraph (27th July 1968) commented that the

> "true state of a company's affairs bear little resemblance to its audited accounts".

The auditors role in the GEC/AEI affair (see Stamp and Marley, 1970) also attracted considerable adverse comment (The Observer, 31st August 1969; The Times, 11th September 1969; The Times, 25th September 1969; The Guardian, 22nd October 1969). The Economist (30th August, 1969) accused auditors of not believing "in any written rules" (page 44). The Guardian (22nd October 1969) called for action to ensure that the auditors

> "..... really do act as shareholders' watchdogs" (page 15).

However, at this juncture an APC was not formed. But the auditing deficiencies continued to be made visible by the DTI reports and the related press comment. Together these created an environment for the formation and development of the Auditing Practices Committee and the formulation of auditing standards.

Amidst the secondary banking crisis and the related property collapse, The Economist (14th February 1976) carried a headline, 'Britain's auditors are not doing their job' and went on to state that,

> "Civil servants, politicians, and even City folk are beginning to wonder whether the accountancy profession is capable of policing itself. ..... What shareholders think they are paying for, what creditors, depositors, the City, government and the informed public want, should be better: professionalism and judgement. .... unless the profession improves its auditing standards someone else will" (pages 79-80).

The same article criticised Spicer and Pegler for the audit of Wintrust; Arthur Young for the audit of Slater Walker and Touche Ross for the audit of First National Finance Corporation, all secondary banks. It also singled out Binder Hamlyn, Robson Rhodes, Moore Stephens and Price Waterhouse for specific criticisms. The Investors Chronicle (13th February 1976) under the headline 'Watchdog, bloodhound or lapdog' argued that

> "In the case of London and County Securities there is not the slightest doubt that the 1972-73 accounts gave a highly misleading view of the group's situation. ...... the normal safeguards clearly failed. ..... the publicised failures pose the question of how many remain to be discovered. ...... [the ICAEW] will need to show rapidly that it can promote higher standards if the accountancy profession is to be allowed to remain a totally self-regulating body" (page 419).

On 28th February 1976, The Economist scrutinised some published accounts and criticised Coopers & Lybrand and Touche Ross by concluding that

> "the interesting items are the ones the auditors do not mention" (page 90).

On 13th March 1976, The Economist (page 68) further examined published accounts and criticised auditors for accepting novel and questionable treatments. The Investors Chronicle (27th February 1976, page 564) carried a headline 'Auditors: why the watchdog needs a closer watch' and noted the market, poitical and institutional pressures for a stricter regulation of auditors. The Financial Times (10th July 1976) doubted the profession's ability

> "to exercise control over the activities of large accountancy firms" (page 26).

The Times (23rd September 1976, page 19) felt that

> "the much more serious of the issues for the moment is auditing" (page 19).

Even the ICAEW President acknowledged that

> "public confidence in the standards of our performance has been badly shaken by a number of well publicised cases" (Accountancy, November 1976, page 4).

With the accounting standards programme in full swing, the profession could not easily continue to blame accounting laxities. Spurred by critical DoT reports, the press was critical of auditing practices and more were on the way. The Economist (16th February 1976) reminded of such pressures by noting that,

> "Of a long list of 16 Department of Trade inspectors' reports in the pipeline at least two are expected to be extremely scathing about the auditors concerned" (page 75).

Whilst the Investors Chronicle (27th February, 1976) felt that

> "several [DoT reports] will criticise auditors more or less heavily" (page 564).

Through its informal links with the DoT and appointment of senior professional figures as inspectors, the professional bodies and major firms were well aware of the nature of such impending public criticisms and the damage they could do to accountancy firms. Therefore, an Auditing Practices Committee representing the interests of the major professional bodies was formed.

7.1.4: Formation of the Auditing Practices Committee

Between 1961 and 1977, the ICAEW issued 'Statements of Auditing' ('U' series in the handbook), but these were not backed by any organisation which represented the collective interests of the various accountancy bodies. However, from the early 1970s the situation began to change.

In the face of increasing corporate failure, related litigation, critical DoT reports and press comments, the ICAEW decided to devote greater attention to the formulation of auditing standards. Investigations into E.J. Austin (DoT, 1972), Pergamon Press (DoT, 1971a, 1973) and other affairs continued. The auditors were particularly criticised for their role in the collapse of the Pinnock Finance Group (DoT, 1971b). Faced with pressures from the government (Zeff, 1972) and a possible loss of legitimacy and credibility, the ICAEW's 1970 annual report (published, April 1971) responded by stating, "A comparable programme on auditing standards will be taken as soon as resources permit"[7]. The ICAEW's 1971 report noted that the "Professional Standards Committee has continued to consider cases of apparently unsatisfactory work by members which have been referred to the Institute[6].

Further pressures continued to come via the DoT investigations and meetings with senior civil servants and ministers. The ICAEW eventually responded to such pressures by the formation of an Auditing Practices Committee (APC). This APC had four members. They came from Harmood Banner, Coopers and Lybrand, Peat Marwick and Kidsons and had its first meeting in October 1973 under the chairmanship of David Richards, an ICAEW Council member[7]. At that time, the control of inflation was a major political issue and not surprisingly, the APC's "major concerns at the time were the Counter-Inflation Act 1973 and the audit of inflation adjusted accounts" (APC, 1986, page 8). Despite such concerns, the APC did not produce any auditing standards or guidelines and generally kept a very low profile.

Meanwhile, following the failure of the professional bodies to integrate, there was a recognition that on major issues of common interest, the professional bodies should co-operate and present a united front. From such a logic, the Consultative Committee of Accountancy Bodies (CCAB) was born in 1974 (Willmott, 1986). By this time, some co-operation was evident. For example, the membership of the ASSC had been extended to cover representations not only from the ICAEW but also the other professional bodies. However, at this juncture, the professional bodies had not sought co-operation on auditing matters and the APC was not made a Committee of the CCAB. In fact, in July 1975, the Institute of Chartered Accountant of Scotland (ICAS) set up its own Auditing

Practices Committee to guide its members. But the position was soon to change.

The profession was already reeling from the critical DoT reports on Blanes Limited (DoT, 1975) and Roadships Ltd (DoT, 1976b). Then came the revelations relating to the London and County Securities (DoT, 1976a). Significantly, the company was audited by Harmood Banner and David Richards (the APC Chairman) was the partner responsible for the audit. The DoT investigation into L&C was authorised on 11th January 1974 and by 9th September, David Richards was one of the 61 witnesses examined by the inspectors. The questions posed must have reflected wider public and DoT concerns about the nature of auditing practices.

In view of the widespread criticisms, the maintenance of the old APC became politically undesirable and impossible. The ICAEW backed APC had its final meeting in January 1976 and David Richards[10] resigned his Chairmanship of the APC (Accountancy, March 1976, page 13). This APC was disbanded without issuing a single auditing standard.

By 1976, major firms such as Arthur Young, Deloittes, Coopers & Lybrand and others had also received negligence law-suits and more claims lingered on the horizon. The falling rate of profits and liquidity and an ever increasing rate of inflation and liquidations (see chapter 6 for some evidence), provided additional incentives for the creation of a new body for promoting auditing standards and protecting the interests of auditing firms. In the face of DoT and press criticisms, a new CCAB backed APC was set up and had its first meeting on 29th March 1976. One of the major reasons behind the formation of the APC was the belief that a

> "codification of good auditing practice into a set of auditing standards will ...... help to satisfy our critics in political circles and outside (emphasis added) ......" (APC, 1978a, page 50).

The newly constituted APC consisted of 14 members (8 ICAEW; 2 ICAS; 2 ICAI; 2 CACA), with a proviso that the majority of its members shall be in public practice exercising the audit function. The Chartered Institute of Management Accountants (CIMA) was denied any voting representations on the grounds that its members are not permitted to carry out statutory audits. The Chartered Institute of Public Finance and Accountancy (CIPFA), whose members can carry out local authority audits, was initially granted an 'observer' status on the APC (Cranmwell, 1979), but since 1982 has been granted two seats and a full membership status. Thus, despite the claims that audits are a social activity whose consequences affect almost all individuals (Shaw, 1982), the standard setting institution consisted entirely of auditors.

Firms criticised by the Department of Trade inspectors, the press and facing lawsuits came to be the first nominees for seats at the APC. These included Price Waterhouse, Peat Marwick, Spicer & Peglar and Coopers & Lybrand, and others[11]. Such firms were well represented on the working parties of the newly constituted APC and its working parties (see APC, 1976 for a list).

The formation of the APC helped to placate criticisms and the fruits of it labour were now awaited. Such fruits depended upon its domination, control and development. The next section examines the development of the APC.

7.1.5: Development of the APC

Up to 1985, the membership of the APC had not been elected. It continued to be appointed by the directors of CCAB (major professional bodies)[12]. The individuals serving on the APC operated in a part-time capacity and are paid by the seconding firms. They do not sever their connections with their firms and indeed their long-term career prospects lie with such firms. Since its formation, as figure 7.3 shows, the APC has been populated by the major firms.

This includes the very firms which have been criticised by the DTI, the press and have been facing law-suits by other fractions of capital. These include Price Waterhouse, Arthur Andersen, Coopers & Lybrand, Thornton Baker, Peat Marwick, Thomson McLintock, Delittes, Robson Rhodes, Ernst & Whinney, Arthur Young and others. Through their control of the APC, such firms are in a dominant position to shape the meanings of auditing standards and guidelines. A minister[13] has claimed that the

> "major firms do not make audit policy or unduly influence the work of the APC ...... [Its] members are appointed on the basis of contribution they can make as individuals, regardless of the firms to which they belong. ..... it is not surprising that people of the right calibre, who can freely commit their time to professional activities are found more easily in the larger firms"[14].

Figure 7.3

MAJOR ACCOUNTANCY FIRMS AND THEIR DOMINATION OF THE APC

FIRMS	AUTUMN 1976	WINTER 1978	SPRING 1980	WINTER 1980	SPRING 1984	SEPT 1985
PRICE WATERHOUSE	3	1	1	1	-	-
SPICER AND PEGLER	1	1	1	1	-	-
ARTHUR ANDERSON	1	1	-	-	1	1
COOPERS & LYBRAND	1	1	1	1	1	1
THORNTON BAKER/ GRANT THORNTON	1	2	2	-	-	-
PEAT MARWICK/ THOMSON McLINTOCK	1	1	2	2	2	3
TOUCHE ROSS	-	1	1	1	1	1
DELOITTE HASKINS & SELLS	-	-	-	2	2	1
ROBSON RHODES	-	-	-	1	1	1
ERNST & WHINNEY	-	-	-	-	1	1
ARTHUR YOUNG	-	-	-	-	1	1
BINDER HAMLYN	-	-	-	-	1	1
	8 (57%)	8 (57%)	8 (62%)	9 (64%)	11 (69%)	11 (69%)
OTHERS	6 (43%)	6 (43%)	5 (38%)	5 (36%)	5 (31%)	5 (31%)
TOTAL APC MEMBERSHIP	14	14	13	14	16	16
CHAIRMAN FROM	PRICE WATER-HOUSE	SPICER & PEGLER	SPICER & PEGLER	SPICER & PEGLER	COOPERS & LYBRAND	ARTHUR YOUNG

Source: Sikka, Willmott and Lowe (1989).

Wider social constituencies did not have a voting representation on the APC. The Department of Trade sent a 'non-voting observer'[15]. The powerful and influential position of the Chairman, considered to be a "plum professional job" (The Accountant, 25th March 1982, page 406), has been consistently filled by individuals drawn from giant multinational firms (see figure 7.3). Many of the topics upon which the APC pronounces are selected by the Chairman who can also exercise considerable influence on the basic terms of reference of working parties. It should be noted that the Chairmen have come from the very firms implicated in the crisis of confidence in auditing. The government does not make any financial contribution towards the running of the APC. However, for the period under review, the extent of financial resources available to the APC are not known[16]. Another aspect of the APC's development has been that it gives internal documents to major firms, something which is not available to others (Sikka, Willmott and Lowe, 1989). This unequal access to information means that some parties would be able to comment on the issues more effectively than others.

With the professed aim of restoring "the public's confidence in the auditing profession" (APC, 1986, page 61), the APC was asked to develop personal, operating and reporting standards. However, very soon the matter of personal standards was taken out the APC's remit and given to a Joint Committee on Ethics, leaving the APC to concentrate on the remainder. Auditing standards and guidelines as figure 7.4 shows are best conceptualised at three interrelated levels.

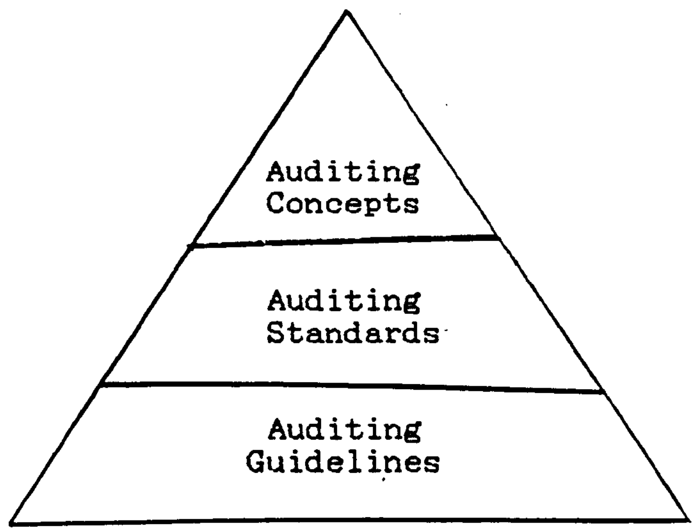


Figure 7.4
Understanding Auditing Standards and Guidelines

The first tier consists of over-riding auditing concepts such as the meaning of an audit, auditor independence, 'true and fair', etc. These issues are highly contentious and are not addressed by the APC. The remaining two tiers are within the scope of the APC's work. The second tier consists of auditing standards which "prescribe the basic principles and practices" (APC, 1980b, para 3). The third tier consists of auditing guidelines which relate to "procedures by which the auditing standards may be applied ..... [to] specific items appearing in the financial statements, ... techniques currently beind used ....." (APC, 1980b, para 5).

After its formation, the APC set about producing draft auditing standards and four individuals from four major firms spent "two weeks of concentrated effort at the end of June [1977] producing drafts" (APC, 1986, page 20). The first draft auditing standards and guidelines were released in June 1978, eventually leading to the publication of Auditing Standards and Guidelines in April 1980. These related to matters such as the auditor's operational standard, audit reports, guidelines on planning, controlling and recording accounting systems, audit evidence internal controls and review of financial systems. Such guidance ,whilst taking account of much of the criticisms by the Department of Trade, also introduced a considerable amount of American jargon to the UK. For example, the audit reports now contained phrases such as 'subject to' and 'except' type of opinions. Rather than referring to vouching and verification, the audit tests now spoke of 'walkthrough tests', 'compliance tests' and 'substantive tests'.

Commenting on the APC's role, A Secretary of State for Trade and Industry stated, "The Auditing Practices Committee .... plays a useful role. The Companies Act is lengthy and detailed. Even so there is frequently scope for applying the law in a number of different ways. The Auditing Practices Committee gives guidance to accountants on what is regarded as best practice in their respective fields ....."[17]. Since its formation, a major aim of the APC has also been to

> "assist the auditing profession in defending itself against unnecessary and inappropriate claims" (APC, 1986, page 61).

Under this, attempts are made to narrow auditor responsibility. In pursuance of this, the guideline on Engagement Letters (APC, 1984) states that an audit "should not be relied upon to disclose irregularities and fraud which may exist" (para 14). Auditing guideline on 'Events after the balance sheet date' (APC, 1982) advocates a 'passive approach'. For example, under the Companies Act 1985 (section 384), an auditor is appointed to hold office from one AGM to the next but the guidance states that "after the date of the audit report the auditor does not have a duty to search for evidence of post balance sheet events" (para 7). This is part of the overall philosophy of defending the 'economic interests' of auditing firms. Such a 'passive' approach is not extended to arenas where the auditor's may have to rely upon the evidence generated by others. In its advice on 'Reliance on other specialists', the APC argued that "the auditor should not passively accept .... evidence" (APC, 1986, page 32).

7.1.6: Section Summary

This section referred to the formation and development of the APC. It has been noted that the auditing wing of the profession has been highly privileged and has considerable influence on accounting and auditing discourses. In the face of increasing criticisms from the DoT and the press, the ICAEW reluctantly set up the APC. However, this APC did not produce any auditing standards and did not last very long. One major reason is that its Chairman David Richards came from Harmood Banner, the firm responsible for auditing the London and County Securities. The adverse publicity surrounding this affair may have forced him to resign and persuaded the ICAEW to disband the APC.

Amidst the 1970s economic crisis, the State was unable to create an independent body to promulgate auditing standards. This gave the profession a further opportunity and a new CCAB backed APC was set up in 1976. This consisted entirely of auditors, even though the consequences of auditing fall upon all sections of a society. Ever since its formation, the CCAB backed APC has been dominated by major firms who have continued to be implicated in law-suits and critical DoT reports. Through their domination of the APC and its working parties, such firms may be in a position to promote their particular 'interests'. The 'users' of financial statements do not have any voting representation on the APC. The APC's minutes etc. are circulated to major firms, but are not available to other interested parties. One of the APC's aims has been to protect the auditing firms from lawsuits even by reducing auditor responsibility.

The remainder of this chapter now examines the way the APC formulated the meanings and implications of the going concern concept.

7.2: CONFIGURATION OF THE WORKING PARTY MEMBERSHIP AND THE RESPONDENTS

In order to understand the institutional meanings of the going concern concept, it is important to be aware of the various players who helped to shape the going concern guideline. Such an awareness will help in understanding the 'interests' being advanced through the meanings of the concept. In view of such aims, this section will focus on the

APC's consultative processes and the parties who responded to the going concern exposure draft (APC, 1983a).

7.2.1: The Consultative Process

The auditing standard setting process, like many other policymaking processes, is legitimised by a 'consultation process' through which policymakers mobilise support for some preferred alternatives. The formation of a working party is an important stage in such a process. According to the official literature, it "considers background material, develops ideas and produces draft Auditing Standard/Guideline" (APC, 1986)

In the case of 'going concern', a working party was formed in Spring 1982, a time of deep economic crisis in Britain. In view of the worsening economic situation, manifesting itself through falling profitability, high interest rates, liquidations and negligence lawsuits (see chapter 6 for evidence) against auditors, the topic of going concern had become important and a working party was thus formed.

As the aim of this thesis is to advance an understanding of the relationship between accounting and society, it was thought that discussions with the members of the working party would be beneficial. A literature search revealed that the professional bodies (for example, CIPFA, 1977; ICAEW 1985, 1986, 1987, 1988) and the APC has published a list showing membership (for example see, APC, 1976, 1978c, 1986) of its working parties. According to the APC[15], the going concern working party last met in July 1984 and was formally stood down in September 1985, but for some reason its membership details had not been published. Therefore, a request for the appropriate information was made. This was also influenced by the APC's stated policies which encouraged communication with the working party members. For example, in 1976, it wrote,

> "....we give below the names of the APC and sub-committee members and hope that readers won't hesitate to contact their nearest members if they have any helpful comments or suggestions" (APC, 1976, page 8).

Thee APC did not provide a list of the working party members, even though its then Chairman was calling for research into the going concern issues (Patient, 1983). At one stage, the APC Secretary offered to reveal the composition of the working party by saying,

> "I have ...... agreed with Mr. Patient [the Chairman] that I will provide you with the names of the working party members on the condition that you do not contact them"[19].

However, in view of the purpose of this thesis, such an undertaking could not be given and the professional bodies refused to reveal the identity of the members (Sikka, Willmott and Lowe, 1989).

As regards the aims of the going concern working party, the APC explained that

> "The working party does not have the responsibility for the auditing guideline. The responsibility for <u>preparing</u> (emphasised in the original) the document rests with the APC ...."[20].

Whilst the ICAEW wrote,

> "....... a working party plays an important role in a project as a whole, it neither produces nor approves the final draft ....."[21].

The Chartered Association of Certified Accountants, one of the APC's governing bodies, emphasised the authority of the working party by stating,

> "it is the final document which members are appointed to produce; how this is arrived at, what weight may have been attached to which argument, is a matter for the members of the committee or working party ...."[22].

According to the official literature, the working parties "vote" (APC, 1986, page 24), but the going concern working party's voting pattern has not been published. When asked, the APC replied that

> "the voting pattern of the working party is irrelevant"[23].

Despite the profession's secrecy, the identity of the working party members was learnt through interviewees from major multinational firms, who had been given lists of all working party memberships as a matter of routine. Subsequently, discussions were held with two members of the going concern working party. These were the the working party chairman and Arthur Anderson partner Ray Hinton and Martyn Jones, a partner in Touche Ross. In addition, discussions with recent Presidents of the professional bodies, members of the APC and partners from some firms provided useful insights into the politics of interpreting the going concern concept. Those interviewed were certain that they were responsible for developing the guideline and making recommendations to the

It is significant that during the development period of the guideline, both Arthur Andersen and Touche Ross were involved in litigation. Arthur Andersen were sued by the government, over the collapse of the DeLorean Motor Company and Touche Ross were facing legal action by Caparo over the collapse of Fidelity (see Chapter 6 for further details). As the subsequent sections will show, these and other firms used the going concern auditing guideline to articulate a particular meaning of going concern. The main aim was to protect the auditing firms from lawsuits, restore public confidence and create conditions for further growth of accountancy firms. Such aims cannot be achieved without mobilising major firms and making 'significant others' feel that their concerns are also being addressed. How was this done?

The manner in which individuals are nominated to a working party has not been explained by the profession. One explanation might be that in view of their considerable experience, senior members of the profession from major firms, are invited to provide an input to policy-making. Such an explanation does not give any indication of 'interests' and is unsatisfactory. An alternative explanation is that the

> "auditing practices committee is dominated by the major firms ...... [such firms] can afford to provide part-time members [and can thus] effectively dominate decisions on the running of a profession in which they have a vital economic interest" (House of Commons, Official Report, Standing Committee D, Companies Bill, 13th June 1989, col. 310).

In any policy-making process, there are numerous formal and informal procedures which enable a power bloc to exercise disproportionate influence. In view of the "closed way in which the [audit policy-making] is handled in this country" (House of Commons, Official Report, Standing Committee D, Companies Bill, 13th June 1989, col. 311), many such arrangements cannot be identified. One way in which a power bloc might maintain its hegemony is through control of information, making it freely available to some and denying the same to others, thus ensuring that the economically powerful can make informed choices. It has been stated that the APC has a policy of

> "providing information on its activities and decisions to the large firms that dominate its proceedings and denying the same information to the rest of the profession - the small accountancy firms. .... [The APC] also gives internal documents to major firms - information that is denied to ordinary accountants" (House of Commons, Official Report, Standing Committee D, Companies Bill, 13th June 1989, col. 311-313).

The unequal information dissemination policies mean that some groups are in a better position to tailor the issues and the agenda to their advantage. As part of this research, it was learnt that major firms do indeed receive 'inside information', both orally and in writing as a matter of routine (for further details see Sikka, Willmott and Lowe, 1989). Later parts of this chapter, with the full approval of an interviewee, will make references to some of these documents.

Having noted some aspects of the consultative process, the next sub-section focuses upon the parties who commented upon the draft auditing guideline.

7.2.2: The Respondents

Following its deliberations, the working party formulated an exposure draft (APC, 1983a) and the professional bodies formally issued it for comments in 1983. The exposure draft attracted 26 responses. The parties making submissions to the APC are identified in figure 7.5.

Some features of figure 7.5 should be noted. 21 of the 26 respondents had prior connections with the APC, either through full membership or participation in various working parties. These included four responses from the APC's governing bodies. In view of the APC's information dissemination policies, this privileged circle would have been able to make informed comments. Only two of the top 15 firms, Arthur Anderson and Binder Hamlyn did not make a written submission. However, Arthur Anderson partner Ray Hinton was the chairman of the working party and would have been able to represent his firm's interests. Whether Binder Hamlyn used any informal lines for making representations is not known.

Chapter 6 noted that discussions of the going concern concept in an auditing context became widespread from the 1970s onwards because of the involvement of many firms in litigation and the pressures generated by public criticisms of auditors, especially through the DTI inspectors' reports.

Figure 7.5

Respondents to the Draft Auditing Guideline

Respondents	Firm Ranking	Criticisms by the DTI or Law-suit	Prior APC Connections
1) Ernst & Whinney (Ireland)	5	Yes	Yes
2) B.R. Addison of Hays Allan(*)	28	-	Yes
3) Deloittes, Haskins & Sells	4	Yes	Yes
4) Arthur Young McClleland Moores & Co.	6	Yes	Yes
5) The Chartered Association of Certified Accountants(**).		?	Yes
6) Spicer & Pegler	11	-	Yes
7) Neville Russell & Co.	17	-	Yes
8) Clark Whitehill.	14	-	Yes
9) Thornton Baker & Co.	8	Yes	Yes
10) Coopers Lybrand	1	Yes	Yes
11) Thomson McLintock	10	Yes	Yes
12) Pannell, Kerr Forster	13	Yes	Yes
13) Ernst Whinney (London)	5	Yes	Yes
14) Peat Marwick	2	Yes	Yes
15) Dearden Farrow	15	-	Yes
16) Price Waterhouse	3	Yes	Yes
17) Touche Ross	7	Yes	Yes
18) Kingston Smith & Co.		-	No
19) The Royal Institute of Chartered Surveyors		N/A	No
20) Mr. Julian Mason (***)		N/A	No

Respondents	Firm Ranking	Criticisms by the DTI or Law-suit	Prior APC Connections
21) The Institute of Chartered Accountants of Scotland (**)		?	Yes
22) The Institute of Chartered Accountants in Ireland (**)		?	Yes
23) Buzzacott & Co	40	-	No
24) Wickens Building Group (****)		N/A	No
25) Chalmers Impey	18	Yes	Yes
26) Technical Advisory Committee of ICAEW (**)		?	Yes

* Writing in private capacity.

** APC's Governing Bodies

*** Lecturer

**** A letter, dated 1st November, 1983 from Mr. Alan Orme, financial director of the company. He is not directly commenting on the draft auditing guideline but replying to seven questions posed in APC's bulletin "True & Fair"; Issue No. 25. Autumn 1983.

Notes

1) Firm classification is based on information published in The Accountant, 26th June 1986, pages 14-16, which gave indication of 1984 and 1985 positions.
2) The only non London firms to respond were Ernst Whinney (Dublin, Ireland) and Thomson McLintock (Edinburgh, Scotland).

3) Analysis of responses

*	Top 15 firms	14
	outside top 15	5
	APC's Governing Bodies	4
	Finance Director	1
	Lecturer	1
	RICS	1
	Total	26

* There were two responses from Ernst Whinney. Missing firms are Arthur Anderson (9) and Binder Hamlyn (12).

It is significant that a large number of written responses came from the firms which had been implicated (see chapter 6) in major reported lawsuits and who have been the subject of criticisms by the DTI inspectors[24]. For example, Ernst and Whinney made an out-of-court settlement in the Hedderwick affair and were facing fresh litigation from Ruberoid and the Allied Irish Bank. Deloittes had made an out-of-court settlement over the collapse of London and County Securities and Power Dynamics. Arthur Young had faced major lawsuits from Tremletts and were implicated in the Johnson Matthey affair. Thornton Baker were criticised by the Gilgate inspectors (DTI, 1981a). Coopers & Lybrand had faced major litigation over the collapse of Burnholme and Forder. Thomson McLintock were criticised in the DoT report on Roadships Ltd (DoT, 1976b). Peat Marwick were criticised by the DoT inspectors in their reports on Lonrho (DoT, 1976c), Court Line (DoT, 1978b) and Orbit Holdings Limited (DTI, 1981b). Price Waterhouse were criticised in the DTI reports on Norwest Holst (DTI, 1982) and Ramor Investments (DTI, 1983). Touche Ross were facing a lawsuit from Caparo. Chalmers and Impey were criticised in the Pergamon report (DoT, 1971, 1973). Arthur Andersen, the firm of the working party chairman, made an out-of-court settlement over the Media Electronics affair and were facing a lawsuit over the collapse of PRISM and the DeLorean Motor Company. In addition, the auditing procedures of Pannell Kerr Forster were being scrutinised by DTI inspectors, appointed on 6th April 1983 to investigate the affairs of the Greenbank Trust (DTI, 1988). In view of the rather close relationship[25] between the DTI, civil servants, professional bodies and major firms, it is quite likely that the preliminary conclusions would have been known to the firm. The crisis of confidence in auditing made visible by the DoT reports, the collapse of many companies and press criticisms also affected the professional bodies, who represent the interests of their members. They could not remain immune from the general criticisms and their own legitimacy was being threatened. As the APC'S governing bodies, they also made comments on the exposure draft and influenced matters through behind the scenes discussion.

The submission by Wickens Building Group (respondent 24) is written by Alan Orme, financial director of the company. His comments are not directly addressed to the exposure draft. Instead, he is responding to the five questions posed in the Autumn 1983 issue of the APC's bulletin 'True & Fair'. Another feature is the relative scarcity of comments from any 'users' of financial statements. The APC was asked whether in developing the going concern guideline, it consulted any users of financial statements? It replied that, "No special consultation took place"[26]. In other words, the auditing guideline was seen as the exclusive domain of the auditor, even though almost every citizen through his shareholding, pension plan, insurance policies, unit trust investment, etc. is affected by the consequences of auditing.

7.2.3: Section Summary

In order to understand the meanings of the going concern concept, this section has provided further information. The parties populating the APC and the going concern working party came from the firms facing law-suits and criticisms. The respondents to the exposure draft came predominantly from the firms with prior connections with the APC and/or facing law-suits. The auditing wing had not permitted non-auditing interests to have a voting representation on the APC and the 'users' were not consulted for the development of the going concern guideline.

The next section examines the way in which the APC went about developing the detailed contents of the going concern guideline.

7.3: UNDERSTANDING THE CONTENTS OF THE AUDITING GUIDELINE

This section examines the detailed contents of the going concern guideline. Most of the guideline covers the meaning of foreseeable future, symptoms of going concerns problems, suggestions that auditors examine corporate plans and budgets and the wording of the audit report. This section will focus on these aspects with a view to understanding the underlying agenda or the 'interests' being advanced by the particular meanings of the concept.

7.3.1.: Meaning of the Foreseeable Future

Discussions of going concern are frequently accompanied by the notion of a 'foreseeable future'. The meaning of the phrase can have serious consequences for auditor liability and perceived responsibility. In the event of litigation, any institutionalised meaning can be invoked by 'significant others' to argue that the auditor owed them a duty for the defined period. Therefore, the meaning of the phrase is important.

Figure 3.3 noted (page 139) that a number of competing meanings have been assigned to the phrase 'foreseeable future'. These refer to 'twelve months from the balance sheet date', 'twelve months from the audit report date' and other variations. However, SSAP 2 (ASC,1971) has not defined the phrase. In formulating the auditing guideline, the APC could also have chosen not to define it, but it stated that

> "While the foreseeable future must be judged in relation to specific circumstances, the auditor should normally consider information which relates to a minimum of six months following the date of the audit report or one year after the balance sheet date, whichever period ends on the later date" (APC 1985a, para 8; also APC, 1983a, para 5).

Alan Orme, a company director wrote to the APC to oppose its formulation. He argued that

> "The auditor should look as far ahead as is necessary to give confidence that the company will trade adequately, and remain solvent, until the following accounts have been filed at the Companies House".

In sharp contrast, the Thames Valley TAC welcomed what it regarded as the "shortening of the period". However, neither the profession's preferred definition nor any explanation of its logic could be found in any prior literature. Indeed, the South Western Technical Advisory Committee sought references to the origins of the APC formula. Of the 12 TACs commenting on the draft guideline, 3 supported the APC position, four felt the period to be too short, two considered it to be too long and 3 were uncertain. The range of meanings advocated by the respondents is shown in figure 7.6.

Figure 7.6

Advocacy of Foreseeable Future in Submissions to the APC

Option	Supported by
The APC position	Coopers & Lybrand, Thornton Baker, Price Waterhouse, Peat Marwick, Arthur Young, Neville Russell and Thames Valley, Sheffield and Manchester TACs
One year from the date of the audit report	Deloittes, Thomson McLintock Spicer & Pegler and Liverpool, London and South-Eastern TACs
Minimum of six months from the date of the audit report	CACA
One year from the date on which the directors sign the financial statements	Pannell Kerr Forster
Upto the date of the audit report or one year after the balance sheet date, whichever is the earlier	Northern TAC
Next trading year or six months from the audit report date whichever is the maximum	Ernst & Whinney (London)
Two to three months after the audit report date	Deardon Farrow
No specific period	Hays Allan, Touche Ross, Chalmers Impey, Kingston Smith, Wickens Building Group; Beds Bucks Herts, Leicester and West Yorkshire TACs

It is interesting to note that the APC definition was supported by major firms, such as Thornton Baker, Arthur Young, Price Waterhouse and Peat Marwick, all involved in litigation and/or DTI criticisms in the aftermath of a business ceasing to be a going concern. Arthur Young drew attention to the

> "obvious danger that any time limit suggested by APC will be seen as a guarantee period ...." [and agreed to accept the guidance] "only if this is accompanied by a clear statement that it is not the auditors responsibility to guarantee the solvency of the enterprise for that period".

Ernst & Whinney (London) objected on the grounds that any definition would be

> "interpreted as placing on auditors a responsibility to attest to the ability of their clients to continue as going concerns".

Some firms, such as Hays Allan were opposed to the specification of any period on the grounds that

> "these time factors could be used against the auditor".

The concern with liability persuaded Deardon Farrow to suggest that 'the foreseeable future' should be defined as "a period of two to three months after the date of the audit report". The CACA favoured the option of six months from the audit report date on the grounds that this would "reduce the review of the foreseeable future period to a minimum". Firms such as Deloittes were concerned that too short a definition would attract public criticism and instead suggested that the profession favour a much more traditional meaning, such as one year from the audit report date.

A working party member explained that the issue of 'foreseeable future' was widely discussed with partners from selected major firms. After such discussions, the 'twelve months after the audit report' option was soon rejected as it presented required auditors to do extensive work. The APC felt that in the case of a private company which took the maximum legal time allowed (at the time, ten months after the balance sheet date) to file accounts, auditors may have to look at, and consider, events for nearly two years after the balance sheet date. This was considered to be too onerous for auditing firm profitability and liability and thus rejected. Some APC members were keen to specify a period of only three months after the audit report date, but were concerned that the press and public may have regarded this as too short. The profession was advised not to opt for too short a period because this might become the focus of litigation. As a member of the going concern working party put it,

> "someone might even be tempted to test it in the courts, if an opportunity arose",

The APC was not aware of any case law on the subject matter and wanted the Accounting Standards Commmittee to innovate, but this was not to be the case. The APC did not wish to leave the definition open-ended, as this would have been counterproductive. In view of the professional pronouncemnts being used as 'benchmarks' in litigation and DTI investigations, the APC felt that the term should be defined, as this could help auditors. A deep seated fear was also that an empty space would invite users, courts or legislation to fill it and that this may not be too helpful to auditors. Ultimately, the APC had to decide on a definition which various parties felt would protect auditors. Under the circumstances, six months after the audit report date seemed a reasonable compromise, with the 'common sense' and traditional interpretation of twelve months from the balance sheet date. An influential partner from a major multinational firm explained that the choice was also influenced by contemporary banking practices, as he knew them. Apparently, many banks were only willing to help some ailing companies for only six months at a time.

In a document distributed to major firms, the APC noted the following and the original formulation remained in the guideline.

Points of Principle	Response
A variety of views were expressed regarding the period suggested in paragraph 5 of the exposure draft as the normal minimum for the "foreseeable future", and a number of alternatives were suggested (for example, 3 months, 6 months or 1 year after the date of the audit report)	Noted. The guidance as stated by the exposure draft is considered to represent adequately the consensus of opinion. No change is therefore proposed (see new paragraph 8)

In summary, this section has shown that the accountancy firms were nervous about the definition of the term 'foreseeable future', in case it could be used against them in a lawsuit. They rejected the definitions which might have imposed additional work upon them. The eventual definition was the result of discussions with highly privileged individuals.

The next section continues to examine the development of the going concern auditing guideline by focusing on the refinement of the auditing procedures advocated by the guideline.

7.3.2: Symptoms of Going Concern Problems

The normal auditing procedures adopted by the auditors are expected to alert them to symptoms of going concern problems. These are listed in paragraphs 10 and 11 of the guideline. Broadly, they ask the auditors to take note of any adverse accounting ratios, financial difficulties and unfavourable market and political conditions (also see figure 7.7 on page 433). How did the APC come across such indicators?

Most of the respondents had little to say on such matters and their suggestions in the main related to presentational aspects. Thornton Baker and Buzzacott wondered how the APC's recommendations could be applied to small enterprises, but such aspects did not receive adequate attention in the eventual guideline. Some firms, such as Spicer and Pegler, wanted "more emphasis" on "consideration of the financial support available and confirmation where possible of such support". Clark Whitehill wanted to see emphasis on "management responsibility" for identification of going concern problems. To clarify the nature of the auditing guideline and the circumstances listed as 'symptoms of going concern problems', the working party members explained that

> "the auditor should look out for the

circumstances mentioned in the guideline. All we are saying is that the auditor should be aware, we do not ask him to go and perform specific tasks".

However, there is an endless list of factors (both positive and negative) which one could focus on. What is the logic between distinguishing paragraph 10 and 11 factors? The reply was that

> "Liquidations, insolvency ..... do not happen overnight. They gather momentum and arise over a period of time .... invariably relating to product, personnel, manufacturing problems .... which invariably manifest themselves in some sort of an earnings related problems .... bad debts ..... obsolescence problems eventually leading to a funding problem. What the auditor needs to do is to recognise the basic problems. Paragraph 10 attempted to summarise such factors, but the list is not exhaustive. Paragraph 10 is about funding. Paragraph 11 identifies matters which may not immediately relate to funding, but will eventually relate to funding".

One problem is that the factors such as low liquidity ratios, overgearing, excessive stocks, etc. need not necessarily be a sign of weakness. In addition to requiring assumptions about normal or optimal corporate behaviour, in many circumstances they may actually be thought of as signs of strength and prudent financial management. Perhaps, the APC could have been more specific in identifying the factors which cause a company to cease to be a going concern. A study of failed companies might have been helpful in identifying the danger signals. A working party member explained that the APC

> "did not carry out any analytical review of companies that had gone into liquidation to see whether some of the factors we identified were present. History may be of interest to

you academics, but we do not have the time - I am not sure whether history is of any great use. We have to deal with the here and now problems"[27].

Whilst another recalled that the appropriate paragraphs (10 and 11 of the guideline) were sent to some liquidator(s) for comment, who considered them to be suitable. Overall, the final list was developed as a result of comments and personal experiences of a few partners rather than any systematic research or a study of company histories. Given the extensive experience of partners from accountancy firms, the APC could have possibly ranked the 'going concern symptoms' in order of their ability to predict problems. Such a ranking might have enabled some auditors to direct their work to key audit areas. A working party member explained that the APC did not want to be too specific as

> "in the event of a corporate failure, a smart lawyer may use the guideline for litigation".

Most of the accountancy firms represented on the APC are multinational and have considerable business interests in the USA (a major market for accountancy services). In order to minimise their training and other costs, it would be helpful, if identical professional vocabularies, techniques, standards and procedures could be established in various countries. Section 7.1 noted that the UK profession had already introduced considerable USA terminology in the UK. In this context, it is interesting to note that the APC appears to have influenced by the going concern symptoms listed in the American standard 34 (AICPA, 1981). Figure 7.7 shows a considerable similarity between the two documents.

Figure 7.7

Going Concern Problem Indicators
A Comparison of the American and British Pronouncements

A) Information that may indicate solvency problems (para 10)

AICPA (SAS 34)	APC
1) Recurring operating losses.	1) Recurring operating losses.
2) Working capital deficiencies.	2) Working capital deficiencies.
	2a) Financing to a considerable extent out of overdue suppliers and other creditors.
	2b) Heavy dependence on short-term finance for long term needs.
	2c) Excessive or obsolete stock.
	2d) Long overdue debtors.
3) Negative cash flows from operations.	
4) Adverse key financial ratios.	4) Low liquidity ratios.
	4a) Over gearing in the form of high or increasing debt to equity ratios.
	4b) Under capitalisation.
5) Default on loan or similar agreements.	5) Default on loan or similar agreements.
	5a) Borrowing in excess of limits imposed by debenture trust deeds.
6) Arrearages in dividends.	6) Dividends in arrears.
7) Denial of usual trade credit from suppliers.	7) Restrictions placed on usual trade terms.
8) Noncompliance with statutory capital requirements.	8) Non-compliance with statutory capital requirements.
9) Necessity of seeking new sources or methods of finance	9) Necessity of seeking new sources or methods of obtaining finance.
	9a) Significantly increasing stock levels.

AICPA (SAS 34)	APC
	9b) Deterioration of relationship with bankers.
	9c) Continuing use of old fixed assets because there are no funds available to replace them.

B) Information that may raise a question about continued existence without necessarily indicating potential solvency problems (para 11)

AICPA (SAS 34)	APC
10) Loss of key management or operations personnel.	10) Loss of key management or staff.
11) Work stoppages or other labor difficulties.	11) Work stoppages or other labour difficulties.
12) Substantial dependence on the success of a particular project	12) Substantial dependence on the success of a particular project or on a particular asset.
13) Uneconomic long term commitments.	13) Excessive reliance on the success of a new product and uneconomic long term committments.
	13a) Size and content of the order book and potential losses on long-term contracts.
14) Legal proceedings, legislation or similar matters that jeopardize an entity's ability to operate.	14) Legal proceedings or similar matters that may jeopardise a company's ability to continue in business.
	14a) Frequent financial failures of enterprises in the same industry.
15) Loss of a key franchise, license or patent.	15) Loss of a key franchise or patent.
16) Loss of a principal customer or supplier.	16) Loss of principal supplier or customer.
17) Uninsured catastrophes such as drought, earthquake or flood.	17)Undue influence of a market dominant customer.
	17a) Political risks.
	17b) Technical developments which render a key product obsolete.

Did the policy-makers pay sufficient attention to the problems of small companies and the traditional meanings of going concern, where the concept is frequently associated with discussions of valuation bases? The next section examines these matters by focusing upon the policy-makers views on the development of additional auditing procedures.

7.3.3: Additional Auditing Procedures

Having been alerted to the problem factors and noted the mitigating factors, the guideline asks the auditors to perform some additional tasks. These include examination of company plans, budgets and forecasts. Even small companies are expected to develop plans and forecasts. These aspects are listed in paragraphs 12 and 13 of the guideline. The APC did not wish to rank any of the factors identified in paragraphs 12-13 as this, according to a working party member, could give the appearance of the factors being "definitive" and

> "could be a very damaging weapon in the hands of a smart lawyer".

The working party members interviewed felt that the auditor's examination of forecasts and budgets for small companies could be problematic. In many cases, the auditors would be preparing and then examining the same forecasts. Such actions might suggest that the forecasts have been effectively authenticated by the auditors. This had serious implications for auditor liability and result in lawsuits.

Since the 1970s, auditors have been urged to examine forecasts (for example, Strachan, 1975; AISG, 1975; Blackwood, 1976), but some APC members wanted to ignore them as these were regarded as highly subjective and thus prone to errors. The feeling was that any association with such data could become a source of litigation in the future. However, the members were also aware that much of the press and DoT criticisms related to situations where the auditors had ignored profit and cashflow forecasts. This meant that the importance of forecasts, budgets and plans in making going concern evaluations had to be acknowledged. Such a public acknowledgement did not necessarily follow that the auditors would use such data. As an APC member put it,

> "Whether auditors will use such information is up to them, it is a matter of judgement".

Hinton (1985), chairman of the working party explained that the guideline will only have a minimal impact on audit work. He stated that the auditing procedures mentioned in the guideline will "not normally involve detailed considerations of budgets, plans etc. It involves no more than an awareness for the future". A related question is whether small companies prepare plans and forecasts? When pressed, a working party member said,

> "I cannot imagine why smallness goes with uncertainty and why small businesses will not have plans.... in the vast majority of cases the auditor can do a number crunching job and come up with something based on management's assumptions anyway".

However, firms such as Kingston Smith drew attention to the very limited value of forecasts in resolving going concern uncertainties. This is because the "financial forecasts and budgets will in the vast majority of cases be prepared on a going concern basis".

The guideline seems to suggest that the going concern problems are primarily related to finance and that the auditors could protect their litigation position by seeking 'comfort letters' from bankers and group members. The theme of minimising the audit work and protection from litigation continues throughout the guideline. Auditor responsibility remains somewhat ambiguous.

According to the guideline, if the auditor has serious going concern doubts then recoverability and classification of assets and liabilities needs to be considered. Such logic suggests that a different kind of accounting is appropriate for 'going' and 'non-going' concerns. How will the auditor cope with the various valuation bases? A working party member explained that it is up to the directors to make accounting choices and for auditors to form an opinion thereon. But does this not mean that the auditor still needs to be familiar with the various bases of valuation? The reply was that

> "the auditor only forms an opinion. We are not concerned with the valuation ...... ".

Earlier it was noted that the auditing guideline has a considerable similarity with the equivalent American pronouncement. Such similarities were thought to be beneficial to larger firms as it enabled them to make savings on training and exchange of personnel. Following such thinking, a further comparison has been taken in relation to the mitigating circumstances mentioned in paras 12 and 13 of the guideline. The results are shown in figure 7.8.

Figure 7.8
Mitigating Factors
Comparison of the American and British Pronouncements

AICPA (SAS 34)	APC
1) Disposability of assets not operationally interdependent.	1) Ability to dispose of assets or to postpone the replacement of assets without adversely affecting operations.
2) Capability of delaying the replacement of assets consumed in operation or of leasing rather than purchasing.	2) To lease assets rather than purchase them outright.
3) Possibility of using assets for factoring, sale leaseback, or similar arrangements.	
4) Ability to replace assets which have been destroyed.	
5) Availability of unused lines of credit or similar borrowing capacity.	5) To obtain new sources of finance
6) Capability of renewing or extending the due dates of existing loans.	6) To renew or extend loans.
7) Possibility of entering into debt restructuring agreements.	7) To restructure debts
8) Separability of operations producing negative cash flows.	
9) Capability of postponing expenditures for such matters as maintenance or research and development.	
10) Possibility of reducing overhead and administrative expenditures.	
11) Variability of dividend requirement.	
12) Capability of obtaining additional equity capital.	12) To raise additional share capital.

AICPA (SAS 34)	APC
13) Possibility of increa sing cash distributions from affiliates or other companies.	13)To obtain financial support from other group companies.
14) Availability of qualified persons to fill a vacated key position.	14) Availability of suitable persons to fill key positions.
15) The likelihood of suitably substituting for a lost principal customer or supplier.	15) The likelihood of finding alternative sales markets when a principal customer is lost.
16) The possibility of adequately replacing assets seized or destroyed.	16) The ability to replace assets which have been destroyed.
17) Capability of operating at reduced levels or of redeploying resources.	17) The possibility of continuing the business by making limited reductions in the level of operations or by making use of alternative resources.

A considerable similarity between the two pronouncements should be noted. Commenting on the similarities between the American and the British guidelines, an APC member suggested that the

> "Americans lead in auditing standards and we follow. .... in the long run it is cheaper .... there is no point in reinventing the wheel, is there? Besides, we have to operate on a very short time horizon and there is no time to start afresh ....".

To sum up, the guideline advocated additional auditing procedures mainly by focusing upon the interests of large firms. The APC also borrowed from the American Standard. The guideline had little to say about questions of valuation or the problems faced by smaller firms. Such issues were not considered to be major by the policy-makers.

The next section examines the advice given on audit reports, which is influenced by the 'economic interests' and deeply rooted auditing practices.

7.3.4: Audit Reports

According to the guideline, if the mitigating factors and the additional audit evidence suggests that the auditor has no material doubts about the ability of an enterprise to remain in existence, then an unqualified audit opinion should be given. If he is uncertain then assets/liabilities may need to be reclassified. The guideline suggested (paragraph 24) the use of an 'emphasis of matter' type of audit report, which is meant to highlight some situations, but according to the auditing standards (APC, 1980a) it is not meant to be a qualification. In their written submission, Coopers & Lybrand were concerned that 'emphasis of matter' may be misinterpreted by readers as a qualification. Touche Ross strongly opposed the need for an 'emphasis of matter' type of audit report for the same reason.

During interviews some partners were apt to see the 'emphasis of matter' report as a 'soft option' and indeed viewed it as a kind of a qualification. The working party members acknowledged that small practitioners may use it as a "cop out", but felt that such a report had to be included as it gives the auditor opportunities to protect himself. Some additional points should also be noted. The British auditing standards introduced in April 1980 treated 'going concern' as a 'material but not fundamental' uncertainty and suggested a 'subject to' type of audit opinion though a 'disclaimer of opinion' was not ruled out in exceptional circumstances. The 'subject to' type of audit opinion is of American origins has a chequered history (Carmichael, 1972). In the USA, its use has been criticised by the Cohen Commission (AICPA, 1978) who described it as 'misleading' and 'confusing'. The Canadian position is that the uncertainties should be disclosed in the notes to the accounts. If the notes are satisfactory then there is no need for the auditor to issue a qualified report as a qualification may prove to be misleading and confusing.

Amongst the respondents, Touche Ross favoured the Canadian position. The working party members explained that the Canadian alternative was discussed and rejected, because the major firms felt that the auditor should have opportunity to issue qualified audit opinion. The working party members explained that some firms were also opposed to the Canadian position because in their view

> "such an approach would make the accounts too voluminous and thus reduce their usefulness".

A senior partner from a Big-Eight firm doubted whether British companies would be willing to disclose the necessary uncertainties and added,

> "we [auditors] are only at a company for a very short time. The public has a very incorrect impression of what we can do in that period. We cannot push the management into disclosure they don't want to make".

The original going concern specimen audit report (APC, 1980a), drafted at a time of a liquidity crisis, related going concern problems to lack of finance, but the new version (APC, 1985a) related to losses and finance. Why the shift? The new wording reflected the contemporary concern with falling profitability. A working party member explained that the new report emphasised earnings because,

> "obtaining finance was not usually a problem for many companies. What was difficult was the ability to generate sufficient earnings to pay the loans. The working party and the APC decided that earnings should be the focus as the ability to raise finance is dependent on earnings".

However, Spicer and Pegler felt that going concern is frequently related to financial support and for this reason preferred the original going concern qualification report. A view echoed by Coopers & Lybrand. Nine TACs opposed the proposed audit report and were concerned that either it was too vague or invited a bank manager to cancel financial facilities. Deardon Farrow and Price Waterhouse also wanted the new specimen audit report to be withdrawn. Some, such as the Leicester TAC, referred to the audit report as "torturous" and "incomprehensible". Deloittes referred to the proposed audit report as "long winded". Deardon Farrow also thought that the proposed report could be damaging to a client. Hays Allan wanted to retain the old report.

The respondents were concerned with the impact of the audit report on client companies and firm responsibilities. With this in mind, Peat Marwick and the South Western TAC wondered whether a 'disclaimer of opinion' was more appropriate than the 'subject to' opinion. Coopers & Lybrand and Pannell Kerr Forster considered the 'disclaimer of opinion' to be inappropriate as this can lead to serious consequences for client company's finance and suvival. The working party members explained that the guideline does not rule out the use of a 'disclaimer'. From the written submissions it is clear that the firms were concerned with the self-fulfilling nature of a going concern qualification. Touche Ross felt that going concern qualifications do cause financial difficulties for the companies. It wrote,

> "it is the duty of those who assume responsibility for setting auditing standards to avoid imposing on auditors an unnecessary obligation to issue reports which have such potentially damaging results".

The firm wanted to protect the auditing firms and suggested that the guideline should state that

> "the reader of financial statements is not entitled to rely on either the fact that the financial statements are prepared under the presumption of going concern, or that the auditor's report is unqualified, as evidence that the enterprise will in fact be able to carry on business as a going concern".

Spicer & Pegler were concerned that a qualification, if inappropriate, could still land the auditor with a lawsuit. In order to protect auditors, Thornton Baker felt that the banks ought to be persuaded to issue guarantees to the effect that

> "bank facilities will not be withdrawn under current circumstances provided the company continues to fulfill its obligations".

A working party member was asked whether the readers would understand the audit report? The reply was that "one hopes they do". The APC did not undertake any research to ascertain the users' views.

To sum up, the audit reports were devised without any research and in the main were based upon the personal perceptions of the working party and APC members. Within the constraints of traditional practices, the formulation is concerned with protecting the auditors' liability position. The Canadian position was seen as contrary to the deeply rooted British practice of qualifying accounts and was rejected. The 'subject to' opinion originally imported from the USA in the 1980 auditing standards was retained, but auditors were left with an option to choose an 'emphasis of matter' report, something which the working party was aware may be used by some firms as a 'soft option' to protect themselves.

7.3.5: Section Summary

This section examined the manner in which the APC formulated the details of the going concern guideline.

Despite the official position that the "APC does not limply accept overseas solutions" (APC, 1986, page 49), it is found that the 'subject to' audit report is of American origin. The evidence presented suggests that the APC borrowed heavily from the American standard for examples of indicators of going concern problems as well as the mitigating circumstances.

The guideline was developed by relying upon the personal experiences of some partners from large firms rather any systematic research, for example, relating to the symptoms displayed by failed companies. Throughout the development of the guideline, the 'user' and other interests had not been consulted. The interests of the small firms appeared to have been inadequately addressed.

Another major aspect is that the APC wanted to produce a guideline which would reduce the incidence of litigation against auditors. In addition, it wanted to protect the economic interests of the firms by controlling the amount of audit work they might have to do. This suggests that an underlying agenda was shaping the meanings of the going concern concept. The next section examines this agenda.

7.4: THE UNDERLYING AGENDA: PROTECTION FROM LAWSUITS AND SAFEGUARDING THE ECONOMIC INTERESTS OF AUDITORS

In the late 1970s and early 1980s, accountancy firms were facing massive lawsuits. These frequently arose in the aftermath of a client company with a clean audit report ceasing to be a going concern. For a considerable time, the profession argued that an auditor does not comment on business solvency and viability, but the contemporary pressures were forcing the profession to be sympathetic to such audit objectives. The profession sought to reconstruct its identity by accepting a competing meaning of an audit. It now acknowledged that "it was reasonable to expect the auditor to consider the future viability of his client" (APC, 1986, page 32). The acceptance of such a meaning, however, had serious implications for auditor liability.

This section shows that the going concern guideline was shaped by sectional interests. The interviews and written submissions to the APC show that accountancy firms were keen to articulate an audit approach, an interpretation of going concern which would minimise their liability, protect them in lawsuits and dampen public expectations from an audit, without any additional audit work.

The written submissions show that the draft auditing guideline was opposed by Touche Ross, Chalmers Impey and six of the sixteen ICAEW TACs. Touche Ross wrote,

> "...... the effect of this exposure draft in its present form is to create a presumption of negligence on the part of the auditor in any case where a company goes into receivership or liquidation and the last audit report did not contain a going concern qualification .... these consequences are clearly not in the interests of the profession: it is our contention that they are not in the interests of the public .... it is the duty of those who assume responsibility for setting auditing standards to avoid imposing on auditors an unnecessary obligation to issue reports which have potentially damaging results".
>
> We are very concerned that the exposure draft in its present form imposes responsibilities that go far beyond those that are desirable in the interests of the auditing profession or their clients ..... it will encourage unreasonable public expectations and result in a vast increase in going concern qualifications and in claims against auditors".

Many of the approving firms were also nervous about a document which sought to discuss the auditor responsibility in any detail. Peat Marwick argued that

> "regarding the content of the proposed guideline and bearing in mind the potential

> legal effects ...... whether such a complex subject is suitable for a guideline at all. ...... It is not an issue which can be addressed in abstract and generalised terms, as the nature of an auditing guideline generally requires".

Price Waterhouse expressed reservations on the draft because it implied that

> "the auditor has a responsibility to undergo an active search for indications of possible going concern problems".

Pannell, Kerr and Forster objected on the grounds that the draft

> "lays too much emphasis on the auditor's responsibility to identify the problems".

Kingston Smith objected on the grounds that the guideline

> "seeks to extend the responsibility of the auditor to an unacceptable extent ......".

Firms such as Deloittes and Thornton Baker, first wanted the directors' responsibilities clarified and preferred the matter to be dealt with via a SSAP, whilst others expressed their reservations on certain aspects. Ernst & Whinney (Ireland) argued that the

> "guideline needs to be carefully balanced and worded so as not to impose on the auditor unnecessarily heavy requirements, with particular reference to avoid the need to refer to going concern concept ......".

Arthur Young objected on the grounds that the guideline

> "appears to add strength to the view of some users that, when an unqualified audit report is signed, the auditor is issuing a guarantee that the entity will continue in business for a certain period".

Coopers & Lybrand were concerned with the

> "danger that accounts users will misunderstand the auditors' role and be encouraged to seek redress against the auditors where a company ceases to be a going concern".

Ernst & Whinney (England) criticised the draft by concluding that it

> "does not strike the correct balance and could leave the auditor unreasonably exposed".

Chalmers Impey objected on the grounds that the guideline was unworkable and impractical.

Overall, the firms were concerned with litigation and protecting their economic interests. The profession had to decide whether the concept justified an 'active' approach or a 'passive' approach to audits. Each approach has economic consequences for the firms, their clients and other social groups.

Under the 'active' approach, auditors would be required to specifically search for symptoms of signs or matters which might suggest that a business may cease in the near future. In contrast, the 'passive' approach does not require the auditors to specifically search for any specific audit evidence. An auditor is only required to carry out additional auditing procedures, if and only if, the normal audit work reveals some contrary evidence (also see chapter 3). The eventual official interpretation can have real consequences for auditor liability, especially as following cases such as

Lloyd Cheyham & Co v Littlejohn & Co (1985), professional pronouncements can provide benchmarks in deciding questions of negligence. In such a context, the meaning of the going concern concept, invoked in professional statements is of considerable significance. The next section shows that the APC responded by legitimisng the 'passive approach' to auditing going concern issues.

7.5: PASSIVE APPROACH TO GOING CONCERN

This section shows that the profession had set out to adopt a 'passive approach' to going concern as this minimised audit effort and gave the best protection from lawsuits.

From the literature reviewed in chapter 3, it is not always clear whether the APC was recommending an 'active' or a 'passive' approach[28]. Hinton (1983, 1985), Jones (1985) and APC (1976) appear to be advocating an 'active' approach, but Woolf (1983b) and Charlesworth (1985) claimed that the APC had recommended a 'passive' approach. Even the respondents to the exposure draft were confused. For example, the Liverpool Technical Advisory Committee (TAC) felt that the exposure draft recommended an 'active approach' whilst Thornton Baker thought that the earlier parts of the guideline suggested an 'active approach', and the later parts emphasised the 'passive approach' and in general failed to clarify "auditor responsibility".. Overall, the ICAEW TACs felt that the 'passive' versus 'active' dilemma was not resolved and that the draft appeared to be confusing and unclear on its general approach. In view of the confusing and contradictory messages, the APC was asked[27] to clarify the messages given. In a reply dated 26th September 1976, the APC explained that the articles by Charlesworth and Hinton were not "in conflict with each other to any significant extent". Some conflict with the APC (1976) was acknowledged, but the letter added, "it is not particularly surprising that an article written several years before the going concern project was begun, and nine years before the guideline was finished, should be reflecting slightly differing views". The same letter now considered the previous thinking to be "ephemeral".

Alan Orme (respondent 24), one of the few non-auditors to write to the APC argued that

> "the auditor most certainly should have a duty actively to look for going concern problem indicators. It is as much a dereliction of duty for him to wait for them [problem indicators] to be presented to them as for him not to investigate historical facts as part of the normal audit".

Amidst such concerns, what did the working party originally set out to achieve? A working party member explained that the APC was very conscious of the 'expectations gap' and a major purpose of the guideline was to try to narrow this gap. It was also explained that the issue of 'passive' versus 'active' approach was almost the very first item on their agenda for the very first meeting. The working party had rejected the Canadian approach (see chapter 3 for a summary) and was aware of the 'passive' advocacy of SAS 34 (AICPA, 1981). The recurring question was how to import it to Britain within the possible constraints of SSAP 2 and the Companies Act 1981. An interviewee recalled that throughout the development period, the major topic of discussion was

> "How do we do it in such a way that we do not put an onus on the auditor to go searching, in other words to make a whole range of inquiries that he would not have made otherwise".

In addition there was also a pressure from major firms who felt that

> "anything which in this particular area articulates the auditors' responsibility .... is desirably not said rather than said".

Despite some reservations, on balance there was a feeling in the APC that the guideline protects the auditor rather than exposing his position. According to a working party member, the solution adopted is that

> "we don't actually have him [auditor] go out and carry out specific steps to see whether the going concern basis is appropriate. What we ask him to do is - as a normal part of his audit work, which he must be doing in any case - to be actually conscious of the factors identified in the guideline to see whether any of these are present and if they are, then to respond to them".

Did the guideline recommend a 'passive approach'? The answer was a clear "yes" from both working party members. What exactly is the message of the 'passive approach'? According to a member of the working party, it was saying,

> "...... go about your audit and by the way if something comes and hits you over the head which suggests that the going concern assumption is not appropriate then you really ought to respond to it, but you don't actually have to make overt inquiries and you don't actually have to think in an overt way about the going concern concept".

But why recommend the 'passive approach'? Faced with a crisis, the profession could have articulated and legitimised the 'active approach', but chose not to. The working party members and recent APC members explained that the 'active' approach extends auditor responsibilities and is uneconomical. The profession has to think of auditing firm profitabiliy and cannot extend auditor responsibilities unless the firms can profit from such an extension. One reason (according to a working party member) for the 'passive approach' was that

> "when we have 300,000 to 400,000 active companies in the country and if you add about an hour of audit time to each then you can imagine what that does to audit fees. 400,000 hours at a minimum of £10 per hour is a lot of additional fees or should I say write-offs, especially as you will do the work and then cannot bill it. We have tried to write [the guideline] particularly in light of such views expressed by [major named firms] and others, ... that we must be very very careful in these areas and not to extend the responsibilities too overtly or to extend them too graphically".

According to a working party member, the most important message (strongly emphasised) of the guideline is that

> "for the vast majority of audits - 90% plus - the guideline will not be germane. In fact, it will not require more than another half an hour of audit time to respond ..... This is very important because we had to pursue that position. We can't go on economically extending standards and we also want to be very careful that we don't over-extend the auditors' responsibilites".

Another reason for the 'passive' approach related to the possible references to auditing standards and guidelines in court cases as benchmarks. A working party member explained that

> "As a practical matter, the APC cannot let such things [issues of auditor responsibility] go by for long without these things to be referred in auditing standards. ..... few people fully recognise that the APC is in a more difficult situation than the ASC. It is rare for a legal suit to take place on accounting standards. Such standards are unlikely to find their way to the courts and be contested. The sort of things the APC has to deal with are very much to do with the credibility of the profession. There is no political way for us to standstill".

The 'passive'/'active' confusion did not end with the publication of the guideline either. For example, two Canadian authors (Boritz and Kralitz, 1987) interpreted the guideline as advocating an 'active approach'.

During interviews, Mr. M.J.C. Butchers, a senior civil servant at the Department of Trade and Industry and its representative on the APC denied that the APC had intended to promote a 'passive'. This view conflicts with the article written by Robert Charlesworth (the APC Secretary). In this respect, it would be helpful to refer to a document circulated by the APC to major firms[30]. It shows that in order to protect the 'economic interests' of auditing firms, it intended advocating a 'passive approach' all along. It noted the following:

<u>Points of Principle</u>	<u>Response</u>
..... The auditor should not normally be required to search actively for going concern problems, or to carry out any additional work when considering the appropriateness of the going concern basis	This was the original intention. Paragraphs 6, 14 and 15 (as now renumbered) emphasise that although the auditor must be satisfied that the going concern basis is appropiate, and must consider any evidence to the contrary,

> no specific additional procedures will normally be necessary. Indications of possible going concern problems will normally be identified by the auditor's other procedures. (Only when the validity of the going concern basis is called into question are further procedures required)[31].

To sum up, this section has shown that the formulation of the auditing guideline (APC, 1985a) was motivated by a need to protect the 'economic interests' of auditing firms and to reduce the incidence of litigation against auditors without any meaningful increase in audit work. The intention of the working party and the APC was to promote a 'passive approach' in line with SAS 34 (AICPA, 1981). Many accountancy firms were hostile to the original exposure draft, but the wording hardly changed in the revised version, possibly due to compromises and behind the scene discussions amongst the major firms. This concern with liability, responsibility and profitability is present throughout all considerations of the auditing guideline and is a major determinant of the meanings assigned to the going concern concept.

7.6: CHAPTER SUMMARY AND DISCUSSION

The purpose of this chapter has been to examine the formulation of the auditing guideline, 'The auditors consideration in respect of going concern'. This embodied institutional interpretations of the going concern concept in an auditing context, considered to be 'fundamental' in accounting thought.

The ASC (1971) described the 'going concern' concept as fundamental to accounting, but the APC (1980a, 1983a, 1985a) felt it to be 'material but not fundamental'. Chapter 3 noted that the traditional interpretations of 'going concern' frequently involve discussions of valuation concepts. However, in an auditing context, the guideline did not do so. Historically, the concept has also been associated with discussions about disclosure (e.g. cashflow), but here the APC felt that the management would not be willing to disclose the uncertainties and ruled out such a step. Seemingly, the interpretations have considerable regard for auditor-director relationships and the auditors showed considerable sympathy with the interests of the directors, who are effectively responsible for appointing auditors and upon whose patronage auditors also rely for non-auditing and other income.

As chapter 6 noted, most of the discussions about the concept were propelled by an economic crisis. This, accompanied by legal changes and the sharpening of conflict between accountancy firms and other fractions of capital, resulted in lawsuits against auditors. The major firms were keen to protect themselves from litigation. This chapter has shown that the guideline was developed with that in mind. Faced with a crisis, the profession was sympathetic to an earlier and subordinate meaning, mainly that going concern is concerned with 'survival of a company'. The acceptance of such a meaning enabled the profession to reconstruct its social identity. However, the profession only accepted a 'passive' responsibility to make going concern evaluations. The 'passive' approach justified minimum audit effort. Such an approach is only articulated in the case of 'going concern' and is not adopted, for example, in relation to verification of accruals or consistency of accounting policies etc. - also defined as 'fundamental' in accounting (ASC, 1971). The particular meanings of the going concern concept were shaped to safeguard the 'interests' of major accountancy firms who were facing a rush of litigation. With professional pronouncements increasingly being treated as benchmarks in court cases and the DTI reports, the institutional interpretations of the going concern concept were seen as being particularly helpful to auditors in defending themselves in lawsuits. The concern with auditor liability affected a broad range of meanings, such as those relating to 'forseeable future', audit reports, symptoms of going concern and so on. The going concern audit reports were also designed to provide the auditors with opportunities for protecting themselves, even if it involved using the 'emphasis of matter' report as a 'soft option' or a 'cop out'.

The chapter also noted the 'real' influence of social structures on interpretations of the concept and the institutions. It was the economic crisis, which placed going concern on the profession's agenda and provided a backdrop for the creation of the APC. Such an economic crisis had serious implications for a powerful economic bloc within the accountancy profession, the auditing wing. This bloc had previously managaged to protect itself by arguing that a crisis of legitimacy was caused by the preparers of accounting reports. However, the deepening economic crisis and State led investigation revealed that the auditing wing was not performing its functions efficiently. This exerted considerable pressures and eventually persuaded the profession to form the APC. However, the APC came under the control and domination of the very firms whose activities could be threatened by the creation of this new agency. A major function of the APC came to be to protect the major firms from lawsuits and much of its work proceeded along those lines. The interpretations of the going concern concept are in line with this overall objective. It is noticeable that the working party and the respondents mainly came from firms facing criticisms and litigation. The same firms also controlled the APC. Major firms were also privy to 'inside' information and had ample opportunity to tailor the issues, agenda, wording of the pronouncements, audit report examples and various definitions.

The profession did not publish the identity of the working party, but its identity was known to major firms who were privy to many discussions. The working party had its last formal meeting in July 1984, but the APC received suggestions for revising the draft from major firms after this date. The suggestions were accommodated by holding a meeting on 17th December 1984 to consider the implications of the Insolvency Bill 1984. Minor revisions were also made to the specimen exposure draft after pressures from major firms. One such amendment was made on 22nd May 1985, even though the draft had finally been approved on 25th March 1985.

The extent of opposition, if any, to the guideline within the APC is not known as the details of voting are not published. According to the APC's Constitution, the approval of two-thirds of the membership is required for the release of a guideline. This means that a vote has to take place and this practice is acknowledged in the official literature (APC, 1986, page 24). A DTI Minister has also confirmed that the APC votes[32]. As Appendix 6 shows, the APC balloted its members on 23rd April 1985, however, the APC did not publish the results of such voting. When the information was requested, the Chartered Association of Certified Accountants (CACA) replied that the

> "APC does not vote .... It will only issue a guideline if there is general agreement to do so. If there were strong and reasoned opposition to doing so, even from a small minority of members, I think APC would endeavour in redrafting to meet the reasoned opposition"[33].

It is tempting to conclude that the major firms' interests are promoted through secrecy and control of information. It is noted that the membership of the APC and its working parties is neither elected nor meets in the 'open'. Access to institutions and information depends upon patronage. Major firms able to make financial contribution being able to have a disproportionate say. The critics may argue that given the influence on the major firms on the auditing market, it is inevitable that they would dominate the institutional structures. Such observations would lend support to Marx and Engels's insistence that in the final analysis, it is the 'economic' which shapes and influences social practices.

Due to the crisis nature of capitalism and various ideologies, the State was unable to create an independent body to formulate auditing standards. However, through its 'observers', the government has been able to have a direct influence on the details of the guidelines. Through the critical reports, the DTI indicated some preferred interpretations of the concept, but the extent to which it intervened in the formulation of the auditing guideline is less clear and visible. Perhaps it is more concerned with promoting accountancy firms in order to secure legitimacy for corporate disclosures and thus act in the long-term interests of capitalism. It is significant that the firms accused by the State of failing to diagnose going concern problems were involved with the formulation of the guideline. The Chairman of the working party came from Arthur Anderson, a firm sued by the government over DeLorean. Arthur Young sued over Johnson Mathey and other firms criticised by the DTI reports were all present on the APC, responsible for approving the guideline.

In developing and approving the interpretations of the concept, quick solutions were being sought, even if this meant relying upon personal experiences of chosen individuals rather than research. The profession heavily relied upon the American standard. It should also be noted that wider constituencies, such as the various 'user groups', were not consulted in formulating meanings and interpretations of the concept. Such groups had no direct representation on the APC or the working party. Furthermore, the lack of information about the working party may have prevented some parties from influencing the interpretations of the concept.

The interests of small practitioners only received secondary attention. The main thrust of the guideline was to give auditors protection from lawsuits without any meaningful increase in audit work. The 'passive' approach was desired because it is more economical and advantageous to auditors. On 90% plus of the audits it was not expected to affect what the auditors already do and where it does affect, the APC reasoned that it would not require more than half an hour's extra time. Such aspects, especially if they protect and promote the material interests, may appeal even to small practitioners and thus persuade them to support the guideline and the APC.

Chapter 7 Footnotes

1) Rather than presenting an encyclopaedic history of the APC, the aim is to concentrate on those aspects which will help in understanding the 'interests' which have shaped the meanings of the going concern concept.

2) For example, see the 'Ethical Guidelines' issued by the professional bodies.

3) A review of the developments relating to the formation and development of the ASSC is not intended here as this has been ably done in other places, for example, see Stamp and Marley 1970; Zeff 1972; Lowe and Tinker 1977; Leach and Stamp 1981; Bromwich, 1985. The intention here is to refer only to some aspects of the episodes relevant to understanding the rise of the APC.

4) Harmood Banner merged with Deloitte Haskins and Sells in 1974. It was not a small firm. At the time of merger it had a UK staff of 1,100 compared to Delotte's 1,600 (Accountancy, July 1979, pages 70-73).

5) A letter from a former Secretary of State for Trade, dated 6th December 1989.

6) These included the 1969-70 ICAEW President and Peat Marwick partner, Sir Ronald Leach; Ernst & Whinney partner Peter Godfrey; Spicer & Pegler partner Richard Langdon; 1972 ICAEW President and Touche Ross partner, Douglas (later Sir) Morpeth; Price Waterhouse partner Martin Harris: Coopers & Lybrand partner David Hobson; Thomson McLintock partner and 1969-70 ICAS President, Sir William Slimmings, amongst others.

7) As published in The Accountant (15th April 1971, page 479).

8) As per The Accountant (20th April 1972, page 512).

9) A profile of David Richards will be found in Accountancy, July 1979, pages 70-73.

10) David Richards went on to be nominated the President of the ICAEW in its centenary year, 1979/80 (Accountancy, July 1979, pages 70-73).

11) The APC's first membership came from the following firms:

Arthur Anders~~o~~en
Barber Harrison and Platt
Carter Newman
Coopers & Lybrand
Hays Allan
Kidsons
Peat Marwick and Mitchell
Price Waterhouse (3)
Pridie Brewster & Gold
Spicer & Pegler
Stokes Kennedy and Crowley

12) Since 1986, the APC has been a division of a private limited company, CCAB Ltd. Its shareholding is as follows:

ICAEW	51.7%
CACA	17.2%
CIMA	14.7%
1CAS	7.3%
CIPFA	6.0%
ICAI	3.0%

13) Letter dated 19th October 1989.

14) However, it should be noted that the firms criticised by the DTI and implicated in negligence law-suits have representatives on the APC.

15) During 1987 (press release dated 23rd April 1987), the APC introduced five observers representing various non-auditor interests, but these are 'non-voting'.

16) The accounts of the professional bodies do not reveal information about the financial resources devoted to the APC. The annual reports of CCAB Ltd for 1985 and 1986 were also examined, but these did not provide any indication either. In fact, the words ASC and APC do not even get a mention in such reports.

17) A letter dated 8th October 1987 from the Secretary of State, Lord Young of Graffham.

18) As per the letter dated 10th December 1986.

19) From the letter dated 26th September 1986.

20) In letter dated 6th October 1986.

21) In letter dated 21st November 1986.

22) Extract from a letter dated 17th December 1986.

23) Letter from the APC, dated 26th September 1986.

24) Only a tiny fraction of DTI reports is published. For example, between 1979 and 1989, some 1,100 investigations were conducted by the DTI, leading to the appointment of inspectors in 56 cases. However, only 13 reports have been published (Hansard, 27th November 1989, col. 93).

25) In his letters of 22nd Septmber 1989, 1st November 1989 and 30th January 1990, the Minister for Corporate and Consumer Affairs has confirmed the DTI practice of providing copies of unpublished DTI reports critical of auditors to the ICAEW. Such reports are not placed in front of Parliament.

26) Quote from a letter dated 26th September 1986.

27) In this respect, the view expressed by a professional body may be of interest. The Secretary of the CACA wrote

(letter dated 27th November 1987), "As one of the bodies participating in the sponsorship and working of a joint committee (APC), we are concerned primarily with the progress and effectiveness of that Committee's work, and less with the intellectual routes travelled by the Chairman and members in arriving at their conclusions".

28) According to Robert Charlesworth (1985), the APC Secretary, the 'passive approach' assumes that the "going concern basis is appropriate, unless indications to the contrary come to his attention as a result of other audit procedures. Only when such problems have been identified does he [auditor] need to apply audit procedures specifically directed towards the going concern basis". The 'active approach' involves "carrying out specific audit procedures designed to obtain positive audit evidence that substantiates the applicability of of the going concern concept" (Charlesworth, 1985).

29) From a letter dated 19th September 1986.

30) This document was provided by an interviewee who confirmed receiving internal information as a matter of routine. See Sikka, Willmott and Lowe, (1989) for discussion of this.

31) Following are the appropriate extracts from the paragraphs mentioned.

> "6) ..... if during the course of his audit, the auditor becomes aware of any indications that the going concern basis may no longer be valid, he should carry out the additional procedures outlined in this guideline. If the auditor's procedures reveal no such indications, it will be reasonable for him to accept that the going concern assumption is appropriate."
>
> "14) In performing the preparatory procedures identified in the Auditing Guideline "Planning, controlling and recording", the auditor should consider whether any of the indications of the nature described in paragraphs 10 and 11 above are present."
>
> "15) Such procedures should not generally encompass any specific additional procedures, since the matter identified above would normally be known to the auditor as a result of his other audit procedures ....".

32) As per a letter (19th October 1989) from the Parliamentary Under Secretary of State for Industry & Consumer Affairs.

33) Letter dated 26th February 1987.

CHAPTER 8

MEANINGS OF GOING CONCERN: EXPLAINING THE PRACTITIONERS' VIEWS

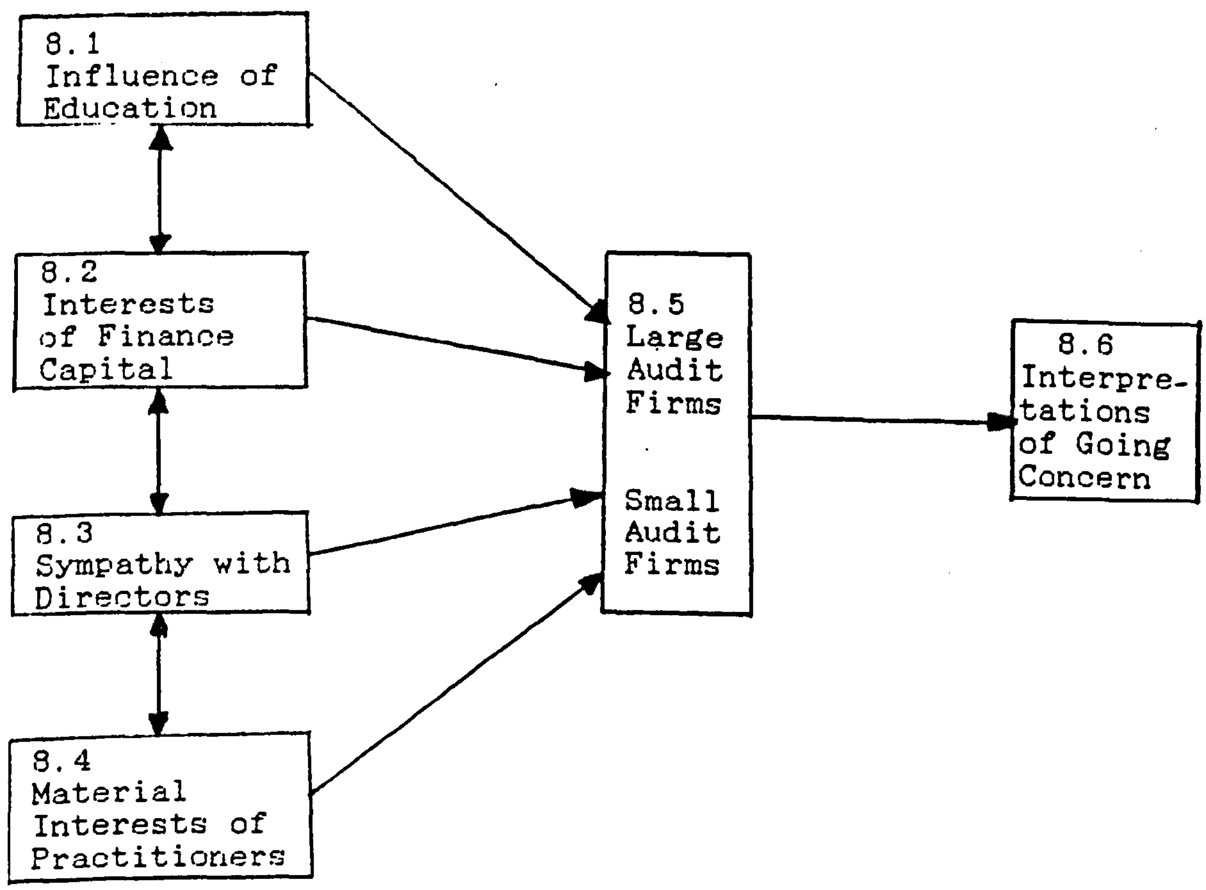
8.0: Introduction

This chapter continues to provide further explanations of meanings, interpretations and implications of the going concern concept in an auditing context. It follows from chapter 4, which referred to what the auditors regarded as the meanings, implications and interpretations of going concern concept. The meanings and interpretations of the concept by auditors were solicited through interviews and questionnaires. The respondents had considerable experience of auditing in general and going concern aspects in particular. Overall, the subjects' auditing experience amounted to 17.91 years on average and all the interviewees occupied senior positions in their respective firms. Chapter 4 noted that many of the interpretations and meanings assigned to the concept by practitioners were often contradictory and also different from those being advocated by the professional bodies. These were summarised in figure 4.1 on page 191. It is as though some practitioners were refusing to be addressed by some aspects of the professional pronouncements.

The explanations offered are within the methodological framework explained in chapter 2. A number of cross-cutting influences which have shaped the practitioners' worldviews and thus help to reproduce and transform the meanings of the concept are identified. These factors are shown in figure 8.1.

Figure 8.1

Practitioners' Interpretations of the Going Concern Concept



The first section (8.1) shows that the nature of professional education is a major determinant of the meanings which practitioners attach to the concept. The second section (8.2) shows that the interests of finance capital help the auditors to make sense of the meanings of going concern. During discussions, almost all auditors argued that identification of going concern symptoms had not been a major problem for them, as they had sufficient professional expertise. A major problem was whether having identified such symptoms, they should qualify the accounts. Almost all argued that a number of material influences and 'interests' prevented them from putting some interpretations on the concept. Such factors included the tendency for auditors to sympathise with the general interests of directors (section 8.3) and the material interests of practitioners themselves (section 8.4), where the concern with litigation and risk reduction are major factors influencing the meaning and interpretations of the concept. The fifth section (8.5) highlights the differences of interpretation by large and medium/small firms. Such firms have different clientele and are thus subject to different economic pressures, opportunities and threats. The large and small firms also occupy different positions within the policy-making structures (see chapter 7) and may thus oppose some institutional meanings. Section 8.6 concludes the chapter with a discussion and summary.

8.1: PROFESSIONAL ACCOUNTANCY EDUCATION AND GOING CONCERN

At the beginning of interviews, each interviewee was asked to give his views on the going concern concept. Chapter 3 has already noted the contradictory and often contentious meanings of the concept. It was shown that the concept has been invoked to justify many practices in financial reporting. The earlier writings by Dicksee, de Paula, Leake and others related the going concern concept to issues concerning the contents of the balance sheet and interim valuation. Since that period, the going concern concept has been invoked to justify the use of original cost, constant purchasing power (CPP), current cost accounting (CCA), deprival values, exit values, entry values, deferring of expenditure, permanent capitalisation of costs, lower of cost and market value rule for inventories, depreciation, cashflow reporting, etc. Going concern concept has been used to justify disclosure relating to doubtful debts and purchases subject to reservation of title. It has also been used to justify numerous treatments of goodwill and avoidance of valuation of assets by property companies. Indeed, it is difficult to think of any area of financial reporting where the going concern concept has not been invoked to support or oppose the need for some information or accounting treatment. Given such a colourful history, there was an expectation that the interviewees would have considerable views on the issues mentioned above.

When asked to give their views on the going concern concept, almost all interviewees started by quoting the standard definition from SSAP 2, in many cases word perfect. However, beyond the standard definition of the concept, it was difficult to engage practitioners in any discussion relating to valuation bases or the contradictory meanings of the concept referred to in chapter 3. In the course of discussions, a vast majority of the inteviewees felt that the going concern concept was of fairly recent origin. "It was the ASC which invented it"; "there was no such thing in my younger days"; "it was certainly not around in my student days"; "It was not in any book I read when I qualified"; "the term became fashionable during the 1970s recession"; "it must have come from America ......"; "I never heard of it until SSAP 2 was issued"; "I had not thought about it, until now" was not an uncommon response. Going concern was not regarded as the result of a particular kind of theory, research or society, but instead simply considered to be "a matter of reality and practicality"; "going concern concept is so obvious to anyone, there is hardly any need to mention or theorise it"; "it is a funny sort of a concept, unlike accruals and consistency, it is difficult to visualise", "it is more to do with preparation of accounts and less, if of any, concern to auditors". Overall, despite the rich history of the concept, the practitioners were unwilling, or unable, to engage in any discussion to disentangle the meanings and interpretations of the concept. The practitioners' focus on what they regarded as 'practical concerns' ruled out discussions relating to valuations and disclosures which form the heart of much of the historical and contemporary debates on the concept. Practitioners continued to express the view that they do not "have any difficulties with the meaning of going concern. It seems to be a practical matter, rather than theoretical"; "concepts are of interest to academics, we at the coal-face are interested in hard facts and practical matters"; "this firm's survival and perhaps I should say my income depends on identifying going concern problems, I do not see how questions of valuation and disclosure are related to that", were some of the sentiments expressed by practitioners. Most were content to accept whatever valuation base the accountancy bodies recommended. According to them it was up to the professional bodies to guide the accountants on the valuations and disclosures appropriate for going concerns.

Whilst numerous factors play a part in shaping the practitioners' worldviews, the influence of professional education on the interpretations of going concern should not be underestimated. The professional education socialises practitioners into role specific knowledge, role specific vocabularies and routines and filters out some issues from consideration altogether. It plays a part in creating and maintaining subjective reality of aspiring practitioners by engaging them in professional conversations, promoting a particular kind of social order and relations of power to shape their worldviews.

What images of going concern has the professional education process given to practitioners? Such issues cannot easily be addressed without a comment on the nature of professional accountancy education. In the main, professional accountancy education makes little effort to make practitioners aware of theoretical debates, history, institutionalised power and conflicts or contradictions which silently form the backdrop against which meanings are assigned to accounting concepts. Instead, as Hastings and Hinnings (1970) argue, anti-theoretical pragmatism rules. Even though the Royal Charters of the acountancy bodies require them

> "..... to advance the theory and practice of accountancy in all its aspects, including in particular auditing ....." (ICAEW's Royal Charter of 1948).

The professional accountancy education imposes meanings of accounting concepts by requiring the students to continuously repeat and recite them. The text books for professional courses tend to place excessive emphasis on professional pronouncements and less and less time is devoted to discussing anything radical or different (Baxter, 1981). As Tinker (1985) notes,

> "Professional accounting education is certainly not a talking shop for exploring social existence: rather it resembles a rote learning process in which students are inculcated with the profession's party line by pedantic and legalistic methods" (page xx).

The contents of major accounting and auditing text books have also not promoted a wider discussion of the going concern concept. Significantly, despite the earlier debates (see chapters 3 and 5, 6 and 7), and the numerous meanings which various authors have attached to the concept, recent professional literature (for example, Cooper, 1971; Waldron, 1978; de Paula and Attwood 1982; Howard, 1982; Stoy Hayward, 1983), prior to the publication of the draft auditing guideline (APC, 1983a) made little or no reference to going concern in an auditing context. Only fleeting references could be found in Thornton Baker (1981). However, after the issue of the draft auditing guideline, a large number of books (for example, Coopers and Lybrand, 1984, 1985; Thornton Baker, 1983; Millichamp, 1984; Pratt, 1983) began to refer to the concept not by critically evaluating it, but by producing summaries or copies of the guideline. SSAP2 institutionalised the going concern concept in 1971, but despite this Lafferty (1982) did not contain any mention of the concept, whereas Beckett (1980) Farmer (1983), Lewis and Firth (1985) and Gee (1985) tended to repeat the words from SSAP 2 and Companies Acts and little else. It is as though professional accountancy education, combined with other factors, was denying space to the competing meanings. Chapter 7 noted that a powerful elite had formulated the institutional meanings of the concept. Through the education process the 'interests' of the elites are being privileged and the historical debates/developments have been renedered either insignificant and/or invisible.

The contents and context of professional education not only influences discussions of the concept, but also the techniques which practitioners may select to identify going concern problems. For example, accounting scholars (Beaver, 1966; Taffler and Tisshaw, 1977; Kida, 1980) have noted the power of accounting ratios to make going concern predictions and Westwick (1980) specifically recommends them to auditors to identify going concern problems. In view of the long history (Horrigan, 1968; Dev, 1974), the usefulness of accounting ratios is emphasised in numerous accounting books and is an accepted part of accounting folklore and 'common sense'. The going concern definition in SSAP 2 (ASC, 1971) treats the concept as though it is future orientated, i.e. it is defined as "the enterprise will continue in operational existence for the forseeable future" (para 14) which might mean less emphasis on past data. However, accounting is seen as a science where predictions can be made from past experiences and hard data (FASB, 1978; Sterling, 1970). The use of ratios is considered to be 'common sense'. With such an ideology, the auditors also make use of ratios to identify going concern problems[1], frequently looking at trends to see patterns[2]. When asked to explain the reasons for using ratios to make going concern evaluations, many practitioners explained that "all the books show usefulness of ratios"; "the Institute's digest shows their importance"; "I attended courses on going concern where the usefulness of ratios was shown". One practitioner from a major firm, startled by a request to explain reasons for using ratios, telephoned his technical director (TD). The conversation, heard through a telephone amplifier, went as follows:

> Partner: "..... I am being interviewed. ..... why do we use ratios to identify going concern problems".
>
> TD: [after a silence of around 12 seconds] "..... ummm .... What else is there ...... All accountants use them ..... Ratios are in all the books ..... we all studied them and I think even the auditing guideline recommends them. All major firms use them and we have been using them for years with good effect, I might add.
>
> [after more silence]. .... It is a funny sort of a question. The answer is so obvious.
>
> Partner: "I think [the researcher] would like to know the ratios which we specially use and the reasons for that.
>
> TD: "...... Our practice is no different from what one might find in good professional books, journals or the Institute's recommendations. If you send him [the researcher] to me I will show him the books in our library" [3].

Overall, the context and content of professional education is important in influencing which aspects of the going concern would be elaborated and which would be ignored. The meanings and interpretations expressed in books themselves are reflective of the wider relations of power and dominance. But nevertheless, the accountancy profession and professional education mobilises bias by giving institutionalised legitimacy to some meanings and interpretations of the concept, whilst rejecting others.

8.2: DOMINANT INTERESTS OF FINANCE CAPITAL

In view of its growth and development under the influence of bankruptcy practies, the accountancy profession has paid particular attention to the interests of 'finance capital' (Brown, 1905). As chapters 3 and 5 noted, the earlier interpretations of the going concern, especially the rules relating to valuation of fixed assets and floating assets, were formulated with the interests of 'finance' in mind. This also needs to be seen in a wider social context, where the 'interests' of finance are privileged (also see chapter 2).

There is a deeply held belief that the financial statements are primarily for the benefit of 'finance capital' (Bryer and Brignall, 1986). Such beliefs frequently manifest themselves through authoritative accounting pronouncements (for example, American Institute of Accountants, 1936; FASB, 1978; ICAS, 1988; Solomons 1989) which promote a set of power relations and state that the purpose of financial statements is to help investors and creditors to make useful decisions by enabling them to make predictions of future revenue, cash flows, performance, etc. The scholars concentration on the interests of institutional and private investors (Lee and Tweedie, 1976; 1981) and capital markets (for example, Revsine, 1973), further reinforces the reality that financial statements must be, and are, of particular significance to 'finance capital'. Such ideologies are further reinforced through education and accounting and auditing text books (for example, Underdown and Taylor, 1985; Woolf, 1979; Millichamp, 1984) which routinely emphasise the supremacy of investors and creditors. Such images of accounting practice shape the meanings and interpretations of the going concern concept.

The concern with the interests of 'finance capital' is universal amongst auditors regardless of the firm size. This is highlighted by an extract from the questionnaire responses[4] given by auditors. Table 8.1 shows that the going concern qualifications are meant to alert financial investors and creditors. The auditors associate going concern with the information needs of capital markets, creditors, institutional and individual investors. Comments such as "share prices depend on published information and surely without the audit opinion the information would not be very believable, would it"; "no creditor managing his finances properly can afford to ignore the auditors opinion" were common enough. No participant associated going concern with information relating to employees, control of pollution, health and safety, equitable distribution of wealth, social responsibility, etc. It was always associated with the investors' concern for 'financial returns' or the creditors' concern with recoverability of the amounts advanced.

The concern with the interests of 'finance capital' was highlighted whenever the auditors referred to the purpose of audit reports. An unqualified audit report has messages for investors and creditors, implying that a business is financially viable (statement 13). A going concern qualification was described as providing 'red flags' and 'danger signals' which had messages and consequences for share prices, institutional investors and creditors. As statement 5 in table 8.1 shows, 93.1% of the respondents believed that going concern qualifications had serious consequences for such parties. Such beliefs existed even though no participant was able to refer to any evidence which suggested that going concern qualifications influenced share prices, or that the audit qualification safeguarded the value of shareholder investment. When pressed, the response was "it [going concern qualification] must be important"; "...... it has to be"; "...... it is common sense"; "..... it is an important source of information for any investor and creditor"; "surely, our work is of great importance, otherwise one would not see all the press fuss about auditors". From such thoughts, the purpose of a going concern qualification was frequently explained [5] to be 'to alert shareholders and other investors and creditors of impending solvency and liquidity problems'; 'to inform the shareholders that the company has possible financial problems'; 'to alert users of the need for third party financial support which if withdrawn may lead to corporate collapse'; 'to alert the readers of the risks surrounding investments'; 'warning of possible liquidation'. Overall, there was a strong feeling that going concern qualifications have considerable consequences for investors. This sense of importance existed even though 29.2% of the respondents felt that users do not understand the significance of a going concern qualification (statement 29) and 42.8% of the respondents (statement 25) deemed them not to be very informative. Respondents reasoned such views by arguing that "only those who have made reasonable efforts to understand going concern matters have any right to understand them"; "what is important is that the institutional investors understand them"; "what matters is the understanding of major investors"; "as long as bankers and pension funds understand them, I am not too worried"; "I would not expect an ordinary person to understand them, it needs special knowledge and skills". The respondents did not see any contradictions in their responses to statements 5, 25 and 29.

The auditors' concern with the interests of finance capital is shaped by a wider structure of social relations in which the State plays a vital role in legitimising a certain kind of social order. Ingham (1984) refers to the historical struggles and processes which have given 'finance capital' a prominent place in British economy through its ability to finance wars, trades, empires and political prestige. A capitalist economy has to rely upon credit for expansion of trade and production. In a capitalist economy, where the production prcesses are in the hands of private capital, the State has to rely upon the revenues generated by private capital for its own survival. In view of the political importance attached to 'finance capital', it is not surprising that the State has taken active steps to promote and protect the interests of 'finance'. The State has promoted the interests of 'finance capital' through legislative programmes and frameworks (e.g. the Joint Stock Companies Act, 1856; Companies Act, 1985 and 1989; Financial Services Act, 1986). Since the Companies Act 1948, 'secret reserves' are prohibited for ordinary companies, but banks and insurance companies are permitted to have them. The legislation requires auditors to consider the interests of shareholders and creditors (Companies Act 1985, section 390). Such legislation also forms the core of professional education and forms a 'common sense' view of auditors, who have looked to legislation for guidance. For example, early accountants associated going concern with 'costs' because the Companies Act 1862 and the Railways Act 1868 required so. The Companies Acts emphasise the power of shareholders by referring to their right to remunerate auditors (Companies Act 1985, section 385), remove auditors (section 386) and the auditors' obligation to report to them (section 236). Government ministers frequently see audits primarily for the benefit of shareholders only (Accountancy Age, 6th August 1987). When a participant was asked why he considers the 'interests' of shareholders to be paramount in making going concern decisions, his reply was "it is the law ......"; ...... the accounts are for shareholders". The impact of legislation in creating and reinforcing social reality and influencing the auditors' considerations of going concern issues affects what might even appear to be minor issues, such as the selection of accounting ratios for diagnosing going concern problems. Here is a sample of a discussion with practitioners:

> <u>Researcher:</u> ..... which accounting ratios do you consider to be helpful for going concern purposes?
>
> <u>Participant:</u> ..... current ratio, liquidity ratio and ratios like that ....
>
> <u>Researcher:</u> What is the special significance of these ratios?
>
> <u>Participant:</u> Most of the ratios which we use are influenced by our experience and legal requirements. ..... Section 518 of the

> Companies Act 1985 emphasises the importance of these ratios in determining the solvency of a company. This and the Insolvency Act 1986, emhasises the need to be reasonably certain that a company's debts will be paid.
>
> .....The Insolvency Act in particular requires me to focus on current assets and liabilities and ability to protect creditors. Basically, we are guided by law and common sense".
>
> .... I look at company forecasts, because section 173 of the Companies Act 1985 mentions it ......".

To sum up, the interests of finance capital are an important determinant of the meanings and interpretations of the going concern concept which cause auditors to focus on questions of mortgage repayments, debt redemptions, creditor turnover, gearing, interest payments etc. Such approaches to going concern are the result of a particular kind of social order and are influenced by deeply rooted historical and ideological factors which give special emphasis to the interests of finance capital. The State, through its promotion of the interests of 'finance capital', also reinforces the practitioners' social reality. The nature of professional accountancy education also reinforces the dominance of 'finance capital'.

8.3: SYMPATHY WITH THE INTERESTS OF DIRECTORS

Though the interests of finance capital are considered to be paramount in consideration of the meanings and interpretations of the going concern concept, the auditors do not ignore the interests of the directors who effectively employ them. Throughout their work, the auditors have to interact directly with the representatives of various fractions of capital, i.e. directors. Despite the legal rights of shareholders relating to appointment, removal and remuneration of auditors, it is the directors which control such factors and for all practical purposes are the paymasters of auditors. In general, it is the directors, not shareholders, who are known as 'clients'. The auditors have to consider the interests of directors or risk losing their financial rewards. Such economic dependence forces auditors to make concessions and protect the directors' interests. Vivid evidence of this has been provided in many of the Department of Trade reports reviewed in chapters 6 and 7. However, such pressures also create conflicts in that the auditors may be seen as being too close to directors, from whom they are supposed to be independent, and thus risk losing their wider social legitimacy. The auditors make concessions to the interests of directors as long as it is consistent with their own material interests and the concessions are made within whatever is considered to be consistent with the auditor's definition of 'public' or 'professional' interests. Such fears and concerns shape the meanings and implications of the going concern concept.

Table 8.2 highlights the auditor's perception of some of the consequences of going concern audit qualification. These include the belief that such a qualification could increase a client's financial problems (statement 6), precipitate business failure (statement 8) and increase the cost of obtaining finance (statement 9). Such consequences, in the minds of the users, may create negative images of director efficiency and propriety and put pressures upon the auditor for delaying completion of an audit (statement 7) until at least some of the uncertainties could either be resolved, or better dealt with. Such factors and their consequences for auditor-director relationship figured heavily in interpretations of the concept and the auditor's decision to issue a qualified audit report. Auditors were uncertain as to whether a going concern qualification was a comment on managerial abilities or not. There was a tendency amongst respondents from larger firms to argue that such qualifications are purely financial and are not really a comment on the managment. However, 34.4% felt that such qualifications are a very direct reference to managerial abilities (statement 11): "The directors are, of course, concerned with any negative comment"; "they do not want a whole lot of suspicions and questions raised against them" were some of the comments. "By qualifying, I would be saying that the directors have not done their best or been successful in raising finance, managing debtors, cash or even selling......"; "...... everyone knows that it is the directors who appoint auditors, if I insisted on qualifying I had better be ready to be replaced ...... I am not sure whether I should be making these comments", reflect a range of opinions given. Another partner stated, "it is far better for all concerned to co-operate, we are not there to put management down or to put them in a bad light. Auditors are the first people management turn to when faced with viability problems and it is our professional duty to assist them". A number of commentators also interpreted the going concern problem indicators outlined in the auditing guideline as directly relating to management integrity and acumen. The auditors tended to put director welfare above the need to inform the users of financial statements. This was frequently justified by the feeling that auditors "have to give the company a chance to recover" even at the expense of "delay in completing the audit".

One partner (recent member of the APC) explained his attitude by referring to his real experience. He recalled that in the early 70s he was faced with a company whose balance sheet suggested insolvency and in view of the recession, the prospects looked bleak. But he had to trust the directors' "business knowhow" as "they know more about their business than I do". The publication of the accounts was delayed to give everyone a chance of assessing the situation with a cool head. Eventually, after being satisfied on profit on future contracts, a clean audit report was given. The partner went on, "You see ..... by issuing a going concern qualification I might have put that company out of business, but it is a thriving company today. This is a difficult situation, which also poses threats to our legal liability. The easiest situation is where a company's financial situation, or should I say problems, such as losses, not paying creditors or overrunning the overdraft are well known. In that situation, our qualification cannot do harm to anyone. One thing I am sure of is that as auditors we must listen to the directors and not rush into making qualifications which we might come to regret".

The auditors were certain that in the event of any significant doubts about the applicability of the going concern assumption, directors were to be consulted first. The relevant audit evidence has to be collected from directors and, if necessary, auditors would help to generate such evidence. For example, cash forecasts are thought to provide relevant data for assessment of an enterprise's ability to remain a going concern. A number of respondents felt that in the absence of any legal framework requiring companies to provide such information to auditors, they did not always receive such information. However, the director's refusal to give access to readily available forecasts, or to provide/prepare cash forecasts was not seen as impairing the conduct of an audit or infringing the auditor's statutory rights and obligations (section 237, Companies Act 1985). In such circumstances, the auditors did not proceed to qualify the accounts, but held discussions with management and frequently prepared the forecast themselves or assisted the directors or took no action at all[6].

This section has suggested that the auditors' meanings and interpretations of the concept are shaped by their sympathies with the interests of directors. This itself is influenced by the perceived impact of going concern qualifications on companies and the resultant consequences for the material interests of auditors.

8.4: MATERIAL INTERESTS OF PRACTITIONERS

A major determinant of the meanings and implications of the going concern concept is the material interests of practitioners themselves. Auditors exist in a capitalist society where in order to survive and reproduce their businesses they must earn profits. The audit fees (in many cases also leading to the provision of non-auditing services) are a major source of their incomes, property, prestige and status. Such privileges are threatened not only by the possible actions of directors, but also whenever the auditors confront adverse publicity, a lawsuit or risk losing a client. The pursuit of material interests frequently brings auditors in conflict not only with other fractions of capital, but also with wider social movements and concerns. In such an environment, auditors cannot single-mindedly pursue their own material interests. Such a pursuit can lead to open warfare with other fractions of capital and a loss of legitimcay for capital generally. In many cases, compromises have to be made and they shape the meanings of the going concern concept. Table 8.3 highlights some instances where the material interests of practitioners play a particular part in shaping the meanings and interpretations of the concept.

It is the concern with material interests which persuades the auditors to pay attention to some aspects of the valuation debate. Whereas the auditors were unwilling to discuss the appropriateness of any valuation base implied by the historical nature of the going concern concept, they were nevertheless quite concerned about the valuation problems arising out of circumstances where a company is not considered to be a going concern or when a serious doubt exists concerning its survival. According to the professional pronouncements (APC, 1985a), in such circumstances "the auditor should consider the recoverability and classification of assets, the classification of liabilities and the possibility of new liabilities, were the company to cease to be a trading concern" (para 26). Despite the myth of a professional knowledge base, 59.5% of the respondents agreed (statement 30) that for a non-going concern, the auditors do not have the ability to ascertain the recoverable value of assets and considered this to be a problem. Most auditors did not have any direct personal experience of preparing financial statements for non-going concerns, but due to traditional beliefs in accounting, felt that such businesses needed to show their assets and liabilities at break-up or liquidation values. Whilst noting that the primary responsibility for preparing financial statements for non-going concerns rested with the directors, the auditors felt that they would have difficulty in verifying such values, if used, and thus would make them vulnerable to criticisms and possibly legal action. The interviewees aired their anxieties by stating, "the directors could give me a figure of 'recoverability', but I do not know how valid such figures would be"; "at the margin it is difficult for us to judge the recoverability of assets and then say yes this information would be useful ..... ". Another partner stated, "The profession has never explained what is meant by 'liquidation value' or 'break-up value'. I do not have any expertise in that field". The auditors were concerned that by attesting to such financial statements they might invite lawsuits. Indeed, chapters 6 and 7 noted that the fear of lawsuits has been a major influence on the institutional meanings and interpretations of the going concern concept.

In pursuance of short-term profits and returns, auditors look for low cost auditing techniques to identify going concern problems. The auditors make use of accounting ratios because they are already familiar with them. The usefulness of ratios is taught on almost all accounting courses. Faced with a pressure to make going concern evaluations, the auditors fall back on traditional technologies and despite an appeal to claims of professionalism, are reluctant to incur additional costs in exploring new techniques. In order to boost their short-term profitability, the auditors very rarely introduced any new auditing techniques to make going concern decisions. All of the interviewees were asked, but none claimed to have audit routines specific for going concern decisions. "It all depends on the circumstances", was a typical comment. Such evaluations tended to be a by-product of simple analytical reviews in which the ratios already played a prominent part. Appendix 7 shows a checklist headed 'Financial Review Checklist' which, according to a partner in a major multinational firm, contains "all that there is to know about detecting going concern problems". Such a checklist is an all purpose checklist and focuses on operating performance, accounting reports, financing arrangements, future plans and insurance cover. Many of the lawsuits and DTI criticisms mentioned in chapter 6 were due to the fact that the auditors failed to recognise a new or novel situation which threatened the ability of a company to remain a going concern. In contrast, the checklist encourages auditors to audit by the book because such an approach is believed to be more cost-effective. The partners interviewed were reluctant to experiment with techniques such as Z-scores[7] as they found little use for them. Some firms were willing to consider such techniques, but only if the courts and insurers were willing to accept them as part of relevant audit evidence. They were concerned that in the event of litigation, the conclusions reached from such evidence might not be acceptable.

Table 8.3 also refers to some other meanings and interpretations of the concept arising from the material interests of practitioners. An interesting feature of discussions with auditors was that almost all argued that they were able to correctly diagnose going concern problems, frequently by looking at ratios derived from past accounting information and by considering additional quantitative (e.g. Z scores) and non-quantitative (e.g. bank mandates) information[8]. As a Big-Eight partner put it "all you need is good judgement and about six or so accounting ratios and any accountant worth anything will tell you whether the business is likely to continue. ..... I have made going concern evaluations all my life". However, having diagnosed going concern problems and after consideration of additional data, it did not necessarily follow that they would issue a going concern qualification. As one partner put it, "there are so many factors and dangers which we have to consider. ....people do not understand the dilemmas and dangers which we face. ..... If we qualify we would be damned, if we do not qualify, we would still be damned. We have to consider the consequences of qualifying for everyone concerned". Other partners said, "we have to consider our portfolio of clients, competition and the legal environment. We can't dish out going concern qualifications like confetti, but have to be alert to its implications"; "..... the problem is not identification of going concern problems but rather when to qualify or not to qualify"; "suppose we qualified and the company went out of business, we could be open to a massive claim. We try to be positive and avoid qualifications if we can .....". So, what are the factors which persuade or prevent auditors from issuing a going concern qualification and place particular interpretations on the concept? Table 8.3 highlights such factors.

Do the auditors worry about any bad publicity which might result from a decision to issue a going concern qualification? The responses to statement 10 show that audit qualifications are not perceived as giving bad publicity to a firm. As one partner put it, "bad publicity results from not issuing a qualification when the markets are expecting it". In other words, the auditors can protect themselves by issuing a qualification when the publicly available information suggests that this ought to be done. The going concern qualification was also viewed as a 'liability insurance' which would enable auditors to demonstrate their impartiality and propriety.

The auditors' thinking on the whole question of going concern is very much influenced by issues relating to responsibility and liability. Within this context, audit qualifications were seen as protecting the auditor from unwarranted lawsuits (statement 16). The practitioners saw threats emerging from scenarios where they had not qualified, but the 'significant others' were now saying that they should have. A number of respondents commented that the auditors are sued and criticised for failure to issue a going concern qualification and warning the shareholders of problems rather than the tendency to issue a going concern qualification. Such factors may explain the considerable agreement with statement 12.

Responses to statement 26 show that the auditors would prefer to issue a going concern qualification even though the financial statements reveal all material uncertainties. The idea of not being able to issue a qualification was unwelcome by the majority of the respondents. They felt that the qualification protected them. "Nobody has ever been sued for issuing a going concern qualification ..... the press only looks at situations where people with hindsight allege that we should have qualified ...... this is where litigation also comes in", was the comment of a senior member of the profession with more than 30 years audit experience. He also suggested that the rate of going concern qualifications would rise as more and more auditors become caught in litigation and added, "all it needs is a major case or an out-of-court settlement .....". Another partner added, "I can tell you from personal experience that issuing an unqualified opinion is more expensive than a going concern qualification". Indeed, some respondents saw the 'emphasis of matter' report as a qualification which they used to protect themselves from litigation. Some partners felt that by issuing going concern qualifications, the auditing firms were asserting their independence and professionalism and allaying fears that auditors might be colluding with the management. The preferred choice for qualification was a 'subject to' (statement 27) type of report rather than a 'disclaimer' (statement 28). The auditing guideline preferred the 'subject to' report, though it did not rule out the possibility of a 'disclaimer of opinion'. The respondents stated their preference for the 'subject to' audit report by arguing that a disclaimer "carried too strong a message and in the event of a business failure would make auditors the subject of unwelcome attention".

Some partners argued that in a litigious and uncertain environment, the auditors would resort to a higher number of going concern qualifications as a way of protecting themselves from lawsuits. For this reason, some interviewees felt that their firms were issuing a higher number of audit qualifications now than ever before. One senior partner stated, "if you are sued and your private possessions are up for grabs you do not easily forget to hedge .....". In response to statement 35, 38.2% of the respondents felt that they were issuing more qualifications now and expected the rate to increase, especially if any firm is forced to make a massive negligence settlement.

During interviews, the question of issuing a going concern qualification frequently tended to be associated with the possible loss of that client. Around one-third of the partners interviewed associated losing a client as a direct consequence of their consideration of issuing a going concern qualification. Some 39.7% of the respondents felt that going concern qualifications increase the likelihood of auditors losing that client (statement 14). Thus, a going concern qualification is double-edged. On the one hand, it could give protection in a law-suit, whilst on the other it could sour relations with directors and result in the loss of a client. This view was almost equally shared amongst large and small firms. A partner explained thus: "You have to recognise that other firms compete with us. Some firms are willing to accept fairly liberal interpretations of accounting treatments and principles. It is not really surprising then that we would lose a client when someone comes along and says, oh we would not have qualified for so and so, or your financial assurances would have been acceptable to us". Another partner stated, "Often the reasons for a going concern qualification are known or are anticipated in the market, but problems arise when we want to qualify for something which might not be so widely anticipated ......". The auditors, however, felt that a decision to issue a going concern qualification did not have a knock-on effect which persuaded any potential clients to avoid a particular auditing firm (statement 15). Overall, the question of client loss and the resultant impact of auditor income had a considerable impact on the interpretation of the going concern concept and the auditors willingness to qualify.

Chapters 3, 6 and 7 noted that for some authorities, going concern meant reporting on solvency, competitiveness and retention of market shares. However, in fear of extended responsibility and implications for public scrutiny and possible lawsuits, most auditors opposed institutionalising responsibility for reporting on insolvency (statement 17), competitiveness (statement 18), market share (statement 19), analysis of financial plans (statement 20) and reporting on cashflow forecasts (statement 24); whilst others were willing to accept some responsibility if they were to be protected from any subsequent litigation. In the main, the responsibility for such matters was thought to be the exclusive domain of "directors ..... not ours". Such views echo the sentiments of the Auditing Practices Committee which was also concerned with narrowing auditor responsibilities. A recent President of an accountancy body stated, "I guess our work is used to make judgements on solvency and some people argue that this is the major function of an audit. ..... Putting an audit on such a basis is to invite a flood of litigation". Involvement in reporting on competitiveness and market shares was considered to be "dangerous" as the matters were considered to be highly subjective. "These areas have little to do with auditors", was a frequent comment. "If the shareholders want information on such things then they should ask directors not auditors", was a typical reply. "An audit is about verification of facts in the financial statements. It is not concerned with highly subjective and debatable matters". Such views were also opposed by some. For example, a partner stated, "This is what my clients hire me for. I am like a doctor who reads the financial pulse and then decides whether a company is sick or not. I belong to the old school and believe that the public is entitled to the kind of audit it wants as long as it pays for it and suitable safeguards exist for auditors". The involvement with cashflow forecasts was opposed by a significant number even though the going concern guideline asks auditors to examine plans and forecasts. The respondents felt that their involvement with such documents would give an air of authenticity to what is essentially subjective information and pave the way for greater litigation. "Forecasts have a habit of not being fulfilled ...... and we are the only ones with insurance ..... most lawsuits are now emanating from areas where forecasts are involved", was the view of one partner. Overall, the practitioners were concerned with any interpretation of the concept which extended their current responsibility as this was seen as being connected with the likelihood of higher negligence claims.

Opinions were divided as to whether the auditors should explain how he/she made his/her going concern decisions (statement 23). Some participants argued that there was no legal or professional requirement for the auditor to explain such matters, therefore, they would not give this information. Along functionalist lines, some respondents argued that the disclosure would be too cumbersome and make audit reports or financial statements too long. However, the main reason for opposing disclosure related to the question of lawsuits and auditor responsibility. The disclosure was seen as being disadvantageous to the auditor as it would make the users familiar with the auditor's standard of work and further harm the litigation aspects. "The lawyers would go through such matters with a fine tooth-comb and make things difficult ..... I am opposed to anything which articulates auditor responsibility or makes statements which extend our responsibilities", was the stark comment of one influential partner. Despite such reservations, around 49% of the respondents supported the idea of the auditor explaining the basis of his going concern decisions. Such explanations were thought to be helpful in protecting and furthering auditors' interests. Many respondents felt that the disclosure would help to educate the users to see the limits of audit work and would remove the public's misunderstanding relating to auditor responsibility. Such education was seen as being helpful in controlling and reducing the tide of litigation which frequently arises in the aftermath of a business ceasing to be a going concern. An important point to note is that the emphasis tended to be on educating the 'other side' and making it accept the auditor version of responsibilities, as though it is the users who are invoking incorrect meanings of an audit and thus needed educating.

On the one hand auditors owe their appointment and rewards to the directors and will, therefore, have to co-operate with them in order to maintain their rewards. The directors in order to make the published financial information legitimate, also find a need to co-operate with auditors. On the other hand, however, the directors may promote their interests by hindering the auditors' gathering and evaluation of evidence. Within this setting, a conflict arises between directors and auditors in which each party, whilst being dependent on the other, may nevertheless try to further its aims. In this conflict, each party tries to bring resources and weapons to further its material interests. In such a conflict the directors may wish to deny the auditors additional information, or construe their responsibilities in an onerous way. There may be disputes concerning the likelihood of audit qualifications, availability of evidence and so on. The auditors may construe their responsibilities narrowly and refer to professional pronouncements in support. There is a very strong feeling amongst auditors that the going concern guideline strengthens their position in any discussions with the directors (statement 32). The going concern guideline is welcomed as it helped to "remind directors of their responsibilities" and "showed what exactly the auditors'responsibility is"; "remind everyone what we cannot be held responsible for". The participants referred to the increasing incidence of professional pronouncements being relied upon by auditors in litigation cases to defend themselves. The case of Lloyd Cheyham & Co v Littlejohn & Co (1985)[9] was mentioned by most of the interviewees to support the point that professional pronouncements strengthened their position and reduced the chances of successful lawsuits [10]. The professional pronouncements are given a prominence not only in the legal cases, but also in the reports by DTI inspectors and the hearings of disciplinary committees in which they form benchmarks for assessing auditor work. Thus, the auditing guideline is seen as strengthening the auditor's position against any challenges from the directors, the State or any fraction of capital. Some of the comments by auditors were, the going concern guideline "gives us something to hang our hat on"; "we can tell the directors what we are not responsible for"; "In a worse situation, I can refer to the guideline and ask for information"; "it depersonalises audits"; "with increasing incidence of litigation and accusations we need a clear statement of our responsibilities and this guideline helps".

The going concern guideline was welcomed by most respondents (statement 36), even though it introduced very little of what could be regarded as 'new'. It was thought to have aided auditors in "combating the public's expectations"; "a useful reminder of what our responsibilities are" and was thought to "remind the interested parties of the limits on auditor obligation for the going concern aspects". The guideline was thus seen as a major weapon in any negotiations with management and society. However, the auditing guideline was also seen in a negative light by some respondents. The respondents were concerned (statement 31) that the guideline gave the impression that the auditor is attesting to the financial viability of a business, which would open the floodgates to litigation. "The auditors have never had any professional or legal responsibility of forming opinion on financial viability. ... This opinion is formed by the readers of accounts. Our task is to faithfully and accurately provide the information for them to do so", was the comment of one respondent. The impression that the auditor is concerned with financial viability worried some practitioners who feared that in future litigation, the guideline may be cited against them. Indeed, some saw not only the tone, but the very existence of the guideline as a pointer towards increased lawsuits (statement 33). They were concerned that the guideline would draw attention to issues which were previously low key. Such increased attention to auditor responsibility in an uncertain and litigious environment was also an invitation to issue more qualified audit opinions (statement 34) to protect auditor interests and higher audit costs (statement 38).

This section has argued that the meanings and interpretations attached by auditors to the going concern concept are influenced by their material interests. Such interests are protected by accenting the concept in a particular way and narrowing the matters for which auditors are willing to accept any responsibilities.

8.5: LARGE/SMALL FIRM CONFLICT AND GOING CONCERN

The accountancy profession is not a homogeneous profession. Large and small firms have common as well as competing interests. In chapter 7, it was shown that the major firms have come to control the APC, a body responsible for invoking meanings and interpretations of the going concern concept. Through their control of the APC, its working parties and privileged access to information, such firms were able to articulate a preferred meaning of the concept to protect their 'interests'. In the main, they were concerned with promoting their economic interests and reducing the incidences of litigation. The particular meanings assigned to the concept may not adequately reflect the 'interests' of small firms who were not privy to any inside information and had little representation on the APC.

Large and small firms have different clientele and this brings them under differing pressures. Small firms auditing small/medium companies have more direct contacts with owners of the companies and are thus under greater pressure to explain the significance of accounting concepts and auditing approaches. Their conception of audit work may be whatever they have to do to complete an audit. This may include commenting on cashflow, competitiveness and advice on financial resources, which some other firms may not regard as part of an audit. Small firms, due to their relative inability to devote resources to the development of techniques, may wish the professional bodies to advocate clear policies and techniques for making going concern evaluations, i.e. subsidise them and further their material interests. But the larger firms, experiencing increasing litigation, may wish to prevent such developments in case the resulting documents may be cited against them. This section now focuses upon some of the differences in approaches, meanings and interpretations, attached to the concept by individuals from large (top 20 firms) and 'other' accountancy firms. Such differences are highlighted in table 8.4.

One of the major issues which the APC had to confront in formulating the going concern auditing guideline was whether to recommend a 'passive' or an 'active' approach for consideration of going concern issues. As chapter 7 explained, the APC under pressure from large firms rejected the 'active' approach by arguing that it was impractical and opted for the 'passive' approach. It should be recalled (see chapter 7) that most of the respondents to the going concern guideline came from the large (top 20) firms. In addition, membership of the APC has also continued to come from the same major firms. The large firms, with greater contacts with the City of London and increased exposure to litigation may recognise the value of professional pronouncemnts in limiting their liability and thus support the 'passive approach'. Is there a widespread opposition to the 'active' approach, or are there interests which differentiate the firms? In response to statement 21 of the questionnaire (see table 8.4), some 40% of the large firms (from top ten firms) opposed the suggestion of following an 'active approach', whereas only 3% of the medium/small firms opposed such an approach. The large firms, in view of their distance from the 'owners' and frequent lawsuits supported the 'passive approach', but small firms with closer contacts with owners and possibly facing lesser and fewer lawsuits may have reasons to support an 'active approach'. Whilst the narrowing of auditor responsibility under the banner of a 'passive approach' may benefit all firms, it also has negative consequences. The owner-directors might oppose the auditor's conception of responsibilities. The auditor might risk losing social legitimacy. The auditors of small/medium companies, may find it difficult to explain to shareholder directors that they have less responsibility for going concern issues than has otherwise been traditionally assumed. Whenever the auditors undertake procedures to verify intenal controls, stock, loans, bank mandates, etc., they in the minds of non-accountant directors of small/medium companies, at least are creating an image that they are 'actively' reporting on business solvency and survival. The denial of such responsibility can sour relationships with directors - who are effectively employers of auditors. Such factors may have caused some auditors to oppose the adoption of a 'passive' approach. Those advocating the 'active approach' reasoned, that "annual accounts are akin to a prospectus. By reporting on them we are inviting the public to believe that they are meaningful. This means that we must take definite steps to satisfy ourselves that the business will continue". The auditors from small/medium firms indicated that actively evaluating the solvency and liquidity aspects of a business was part of their responsibility. However, the small practitioners could not refer to any auditing procedures used under the 'active' approach, which were different from that used by larger firms under the 'passive approach'. They contrasted the going concern guideline with the general duty of an auditor to actively search for audit evidence and commented that they could "not see how going concern can be an exception to the operational standard ...... requiring the auditor to take specific steps and procedures to satisfy himself". Some felt that the 'passive approach' was contrary to their "legal and professional obligations". Another partner supporting the 'active approach' argued that "the assessment of the financial position should be a vital part of every audit; this is what the shareholders hire an auditor for"; "I do not want to extend auditor's responsibilities any more than we have to, but the alternative is to risk ridicule". When a partner from a Big-Eight firm (and a member of the APC) was asked to comment on the small/medium firm opposition to the 'passive approach', he reacted by saying, "only firms like ours know anything about the going concern matters. It is a very delicate area requiring careful attention and analysis. Most small and medium size firms don't know anything about this area ..... they rarely have to enter this contentitious area. You are wasting your time asking them anything about this important topic".

The firms which influenced the development of the auditing guideline seemed to be more satisfied with its contents. Only 15% of this group felt that the guideline gives the impression that the auditor is giving assurances on the financial viability of the company being audited (statement 31). But 47% of the other firms confirmed this impression. The small/medium firm practitioners felt that the auditor was now intimately concerned with the financial viability of a company. Some explained that the directors frequently expected them to comment upon the financial vulnerability of the company. Whereas, the major firms facing rising litigation, opposed such an audit objective. Individuals from the major firms argued that the whole purpose of the guidelines was to remove such an impression and thus prevent unwarranted lawsuits. Not a single respondent from the top twenty firms felt that the auditing guideline increased the possibility of lawsuits (statement 33), but 28% of the respondents from other firms felt that by emphasising auditor responsibility for reporting on business survival and viability, the guideline actually increased the possibility of lawsuits and consequently they were more likely to resort to issuing going concern qualifications to protect themselves (statement 34) as compared to the larger firms. Some partners also associated incease in their insurance premiums to the auditing guideline.

Not a single respondent from the large firms agreed with the statement that 'the APC guideline is of little use to my firm', but 26% of the respondents from medium/small firms argued that in common with most other auditing guidelines, the going concern guideline was of little use to them (statement 36). "The Institute is more concerned with the Big-Eight" was a frequent complaint. The respondents complained that the auditing procedures advocated in the guideline were not practical for them to apply. The small/medium size firms wanted some advice on techniques specifically useful for identifying going concern problems, but felt that the going concern guideline was silent on such advice. Only 20% of the top 20 firms wanted the APC to indicate the techniques useful for making going concern decisions, but 70% of the other firms wanted the APC to give guidance on techniques (statement 37). One partner who opposed such developments argued that "....... such developments would harm the profession. Everyone will be checking to see what we should have done or whether it was a good technique .... lawyers would be the only winners". Another reason for the antagonisms is that the major firms have the financial resources and economic incentives to develop the appropriate techniques. Whilst the smaller firms may not have the resources to develop such techniques and may be expecting the professional bodies to subsidise them by developing and recommending suitable techniques. As one interviewee put it "we are busy people. The profession needs to guide us on the best practice and techniques. I do not have the time to go and study books and magazines. I expect the profession to tell us". Another commented, "..... the profession has issued guidance notes on SSAPs, surely the same can be done for the guideline". Small firms were also concerned that in the event of any dispute with the client or third parties, the guideline would become a focus of attention and as a defensive measure they are having to expend resources to brush up on techniques and train their staff. "When your staff are working all possible hours, any training means revenues lost", said a partner. As a result 43% of the small/medium size firm respondents felt that the auditing guideline had increased the audit costs but amongst the larger firms this view was only shared by 5% of the firms (statement 38).

95% of the respondents from the top 20 firms disagreed with the suggestion that 'the auditing guideline' has increased the possibility of a lawsuit against their firm' (statement 33), but only 37% of the respondents from other firms shared such views. The major firms felt that the auditor's position has been protected by the guideline, but the small/medium firms were not always so certain. What they feared most was not auditor responsibility being mentioned, but the rather narrow way in which it was being defined. According to the respondents, in the event of any litigation, firms would cite the auditing guideline, but the narrow and passive definition would be damaging to their defence. The small/medium firm respondents saw two alternatives for the profession. Either, very little or nothing should be said about auditor responsibility or very clear statements should be made about it. Overall, they argued that both positions presented some difficulties. If the first alternative is accepted then uncertainty may exist about auditor responsibilities and is likely to lead to disputes with clients and possible litigation, something they were very concerned with. This view differed from large firms who felt that in view of the current debates about auditor responsibilities, as little as possible should be said about the issues. If the second alternative is accepted, then small/medium firm respondents argued that this would help them to explain their going concern obligations to clients. This view is, however, opposed by large firms who argued that the profession's articulations of auditor responsibilities may not meet the public's expectations and this would lead to problems of legitimacy for the social role of auditors.

Another major area of disagreement between the large and small/medium size firms is the definition of the term 'forseeable future'. The APC defined it as "a minimum of six months following the date of the audit report or one year after the balance sheet date whichever period ends on the later date" (APC, 1985a; para 8). The views of the responding firms were highlighted in table 4.11 (page 211). Whilst a variety of meanings depending upon the auditor relationship with clients were expressed, it should be noted that only 19 of the 129 responding firms supported the APC definition. It is significant that the top 10 firms completely supported the APC definition. 14 of the 19 assenting firms came from the firms which were involved with the formulation of the guideline. Once again, the small firms felt that their interests have not been adequately considered. They were uncertain of the source of the APC definition and of the reasons for abandoning the traditional meanings. Concerns were also expressed about the acceptance of the official definition. Comments such as "six months assurance will not be good for our professional image ......"; ".... twelve months from the audit report date is more consistent with the public's expectations" were expressed by many respondents.

The explanations in this section have suggested that the meanings and interpretations of the going concern are not homogeneous across auditing firms. The differences in meanings arise because within the constraints of capitalism, large and small/medium firms service different sizes of clients and hence different sections of the market. Whilst all firms attach importance to techniques, small firms, in view of their relatively limited resources would like to see specific techniques developed by the professional bodies. However, the disagreements between small and large firms are glossed over because the smaller firms feel that their interests are inadequately represented. The larger firms dominate policy-making and through their influence have come to give certain meanings to the concept, advantageous to their 'interests'. Such conceptions are both shared and contested by small/medium firms.

8.6: SUMMARY AND DISCUSSION

This chapter provided explanations of the meanings and interpretations which auditors assigned to the going concern concept. The views were solicited through interviews and a questionnaire. In accordance with the framework presented in chapter 2, this chapter argued that the manner in which practitioners transform the meaning of the concept is influenced by a number of cross-cutting influences. These included influence of education which through the neglect of history and earlier debates on valuation, has made some meanings of the concept less prominent. Such aspects were once considered to be the guts of the going concern concept.

The relative disappearance of earlier themes and concerns may well be connected with the economic changes and pressures of litigation mentioned in chapters 6 and 7.

The key determinant of the meanings of the going concern concept is not some universal accounting theory, but the social relations of power within a capitalist framework. Within this framework there is always struggle and contestation over 'meaning'. This struggle means that some meanings will gain ascendancy whilst others will become subordinate. In this struggle, education played a considerable part in bringing the concerns of the major firms to the fore. The books did not discuss the past themes of the concept but rather tended to repeat the professional pronouncements which privileged the interests of major firms. Students are encouraged to learn the party line and their horizons are rarely extended beyond a legalistic and pedantic approach to accounting concepts. It is within this social context that the meanings and interpretations of the concept are being forged and transformed. Due to the influence of historical factors, the State has also played its part in aligning external financial reporting very closely with the interests of 'finance capital' and considerations of going concern reflect this. Indeed, the audit reports and going concern qualifications are frequently judged in terms of the benefits and ills they confer to 'finance capital'. Though the interests of 'finance' are now deeply rooted in all accounting discussion, the auditors' regular contact is with directors -representatives of capital- who directly employ them. Thus auditors are dependent for their economic welfare on directors. This economic dependence means that auditors have to consider the interests of directors and make concessions or risk losing their economic rewards. Such factors also influence the manner in which the auditors will interpret going concern.

A major determinant of the meanings attached to going concern is, however, the material interests of practitioners themselves. The auditing firms are a significant fraction of capital and in common with other fractions, need to be efficient, make profits and win social legitimacy in order to ensure the survival of their businesses, income, prestige and status. In order to protect and promote their interests, auditors' interpretations frequently privilege those meanings which will protect them from law-suits. Whereas the professional literature asserts that "the auditor is rarely carrying out his work with the thought of subsequent litigation at the front of his mind" (APC, 1986, page 36), the research described here found that matters of litigation were a major influence on the meanings assigned to the concept.

The auditors are particularly concerned with the incidence of litigation, responsibility and any additional costs which might impair their economic rewards. It is the 'economic' which has been ensuring that the auditors pay attention to some aspects of the valuation debates, likelihood of issuing qualification, loss of client and publicity. Such economic interests influenced the auditors' reluctance to become involved in issues relating to reporting on solvency, cash flows, financial plans, competititiveness, market share etc., something which the literature suggests follow from the going concern concept. The auditors tended to interpret going concern in the light of their current problems. Thus interpretations are likely to be episodic and contradictory. The going concern qualifications are also seen as a tool for managing litigation, risk and crisis of responsibility. It is the concern with material interests which makes auditors reluctant to explain the basis of their work to users. The going concern guideline was welcomed because of the way it strengthened the auditor's hand in any conflict with management and feared by some in case it opened the way to greater litigation.

Within the context of pursuing their material interests, the auditors' decide whether a particular interpretation of the concept ought to lead to a qualification. A qualification was frequently seen as giving the auditor a hedge. The interpretations of the concept are not consistent across firms. The larger firms through their domination of the policy-making committees have tried to institutionalise certain meanings and approaches, but the small/medium size firms, as this chapter shows, try to resist such meanings. For example, unlike larger firms, they advocate an 'active approach' to going concern issues. Small/medium and large firms are dependent upon businesses of different sizes for their income. In the case of small/medium business, the owners have a different degree of contact with auditors and thus a greater chance to interrogate auditors. Such closeness and regularity of contact with the owners subjects auditors to a different degree of economic reality and affects the way they interpret the concept.

Chapter 8 Footnotes:

1) The auditors' reliance on accounting ratios to detect going concern problems is highlighted in tables 4, 5 and 8 of chapter 4 (pages 203, 204 and 208).

2) The auditors prefer to see a trend of ratios etc to make a going concern evaluation. The period of the trend is shown in table 7 of chapter 4 (page 207).

3) The books turned out to be ordinary undergraduate and professional books. The technical director talked about the relevenace of his education and the knowledge of his trainees.

4) The questionnaire and all the responses are shown in chapter 4.

5) See table 3 of chapter 4 (page 201) for a list of the meanings which auditors attached to a going concern qualification.

6) A list of the actions taken if the directors do not produce a cash forecast in shown in table 6 of chapter 4 (page 206).

7) Table 4 of chapter 4 (page 203) noted that 20 of the respondents claimed to be using Z-scores. Some criticisms of Z-scores will be found in Laughlin (1981) and Gambling (1985).

8) The techniques and the minimum information which the auditors find useful for diagnosing going concern problems are shown in tables 5 and 8 of chapter 4 (pages 204 and 208).

9) This case was reported in Accountancy, February 1986.

10) In the Lloyd Cheyham case, the auditors were accused of negligence by directors but were exonerated on the grounds that they followed the requirements of SSAP 2.

11) Paragraph 24 of the auditing guideline states that "there may be circumstances where the reader will obtain a better understanding of the financial statements, and of the appropriateness of the basis on which they are prepared, if his attention is drawn to important matters".

TABLE 8.1

GOING CONCERN AND THE INTERESTS OF FINANCE CAPITAL

STATEMENT	% RESPONDING STRONGLY DISAGREE	DISAGREE	UNSURE	AGREE	STRONGLY AGREE
1) Going-concern qualifications cause a negative share price reaction in the client company's share price.	1.5	5.3	12.2	49.6	31.3
2) Going-concern qualifications alert institutional investors to uncertainties inherent in the financial statements.	Ø.8	6.1	5.3	48.9	38.9
3) Going-concern qualifications alert individual investors to uncertainties inherent in the financial statements.	-	9.2	25.2	51.9	13.7
4) Going-concern qualifications alert creditors to uncertainties inherent in the financial statements.	Ø.8	9.9	23.7	42.7	22.9
5) Going-concern qualification is of no consequence.	66.4	26.7	3.1	1.5	2.3
13) An unqualified audit report indicates that in the auditor's opinion the business is financially viable.	11.5	29.Ø	8.4	48.9	2.3
25) Going-concern qualifications are not very informative.	9.2	35.9	12.2	42.8	Nil
29) Users do not understand the significance of a going concern qualification.	6.9	32.1	32.8	26.7	1.5

TABLE 8.2

GENERAL SYMPATHY WITH THE INTERESTS OF DIRECTORS AND GOING CONCERN

STATEMENT	% RESPONDING				
	STRONGLY DISAGREE	DISAGREE	UNSURE	AGREE	STRONGLY AGREE
6) A going-concern qualification is likely to increase the client's financial problems.	1.5	11.5	13.7	61.1	12.2
7) A client experiencing going concern problems should be given more time by the auditor.	13.Ø	32.1	19.1	26.7	9.2
8) Going-concern qualification is likely to precipitate the client company's failure.	7.6	29.Ø	22.9	31.3	9.2
9) A Going-concern qualification is very likely to increase the client's cost of obtaining finance.	2.3	18.3	16.8	44.3	18.3
11) Going concern qualifications are a reflection on the management's abilities.	4.6	32.1	29.Ø	31.3	3.1

TABLE 8.3

MATERIAL INTERESTS OF PRACTITIONERS AND GOING CONCERN

STATEMENT	% RESPONDING STRONGLY DISAGREE	DISAGREE	UNSURE	AGREE	STRONGLY AGREE
10) Going-concern qualifications give bad publicity to your firm	42.7	31.3	13.0	12.2	0.8
12) A decision to issue a going-concern qualification enhances your firm's credibility.	7.6	27.5	28.2	35.1	1.5
14) A decision to issue a going-concern qualification increases the likelihood of your firm losing that client.	3.1	38.9	18.3	37.4	2.3
15) A decision to issue going-concern qualification increases the likelihood of your firm losing potential clients.	16.8	54.2	21.4	5.3	2.3
16) A going-concern qualification will increase the likelihood of a law-suit against your firm.	23.7	47.3	18.3	7.6	3.1
17) Auditors should be required to alert the investors on the likelihood of company insolvency.	16.8	37.4	13.7	26	6.1
18) Auditors should take active steps to satisfy themselves that the business remains competitive in the forseeable future.	26.7	46.6	5.3	19.1	2.3
19) Auditors should take active steps to satisfy themselves that the business retains its market share.	35.1	51.9	8.4	3.1	1.5

STATEMENT	% RESPONDING: STRONGLY DISAGREE	DISAGREE	UNSURE	AGREE	STRONGLY AGREE
20) Auditors should not be required to analyse the company's financial plans.	6.9	41.2	19.8	29	3.1
23) The auditor should explain to the users how he/she made his/her going concern decisions.	12.2	30.5	8.4	42.7	6.1
24) If the companies publish cashflow forecasts then the auditors should be required to report on them.	9.9	37.4	12.2	35.1	5.3
26) If financial statements disclose all material uncertainties, then the auditor should not issue a going concern qualification	18.3	56.5	9.9	12.2	3.1
27) 'Disclaimer of opinion' should be the most appropriate form of audit qualification for going concern problems.	13.0	61.1	18.3	4.6	3.1
28) 'Subject to' audit reports are the most appropriate for going concern qualifications.	3.1	9.2	14.5	67.2	6.1
30) For a non-going concern, auditors do not have the know-how to ascertain the recoverable value of assets.	4.6	25.2	10.7	51.1	8.4
31) The auditing guideline gives the impression that the auditor is giving assurances on the financial viability of the company audited.	3.1	35.1	19.1	37.4	5.3
32) The auditing guideline has strengthened the auditor's ability to withstand pressure from management.	3.1	17.6	15.3	62.6	1.5
33) The auditing guideline has increased the possibility of a law-suit against your firm.	6.9	38.9	29.8	23.7	0.8

STATEMENT	STRONGLY DISAGREE	DISAGREE	UNSURE	AGREE	STRONGLY AGREE
	% RESPONDING				
34) The auditing guideline has increased the likelihood of you issuing a going concern qualification.	5.3	26.7	21.4	45.Ø	1.5
35) We are likely to issue more going concern qualifications now.	9.2	3Ø.5	22.1	37.4	Ø.8
36) The APC guideline is of little use to my firm	13.7	51.9	13.Ø	15.3	6.1
38) The APC guideline has increased the audit costs.	5.3	36.6	21.4	32.1	4.6

TABLE 8.4

LARGE, SMALL/MEDIUM FIRM CONFLICT AND GOING CONCERN

Statement	TOP 20 FIRMS %						SMALL/MEDIUM FIRMS %					
	Strong-ly Dis agree	Dis agree	Unsure	Agree	Strong ly Agree	Total	Strong ly Dis agree	Dis agree	Unsure	Agree	Strong ly Agree	Total
21) The auditor should take active steps to satisfy himself/herself that an enterprise is a going concern.	-	40	-	50	10	100%	-	3	4	64	29	100%
31) The auditing guideline gives the impression that the auditor is giving assurances on the financial viability of the company being audited.	5	60	20	15	-	100%	3	30	20	40	7	100%
33) The auditing guideline has increased the possibility of a lawsuit against your firm.	25	70	5	-	-	100%	4	33	35	27	1	100%
34) The auditing guideline has increased the likeli-hood of you issuing a going concern qualification.	10	65	-	25	-	100%	5	20	25	48	2	100%

Statement	TOP 20 FIRMS % Strongly Disagree	Disagree	Unsure	Agree	Strongly Agree	Total	SMALL/MEDIUM FIRMS % Strongly Disagree	Disagree	Unsure	Agree	Strongly Agree	Total
36) The APC guideline is of little use to my firm.	30	50	20	-	-	100%	10	52	12	18	8	100%
37) The APC should develop an auditing guideline indicating the techniques useful for making going concern decisions.	-	65	15	20	-	100%	3	11	16	63	7	100%
38) The APC guideline has increased the audit costs.	15	65	15	5	-	100%	3	31	23	37	6	100%

CHAPTER 9

CONCLUSIONS

9.0: Introduction

This thesis set out to explore the relationship between accounting and society by focusing upon the changing meanings of the going concern concept. In order to understand the relationship between accounting and society, a methodological framework informed by Marxist thinking was adopted. This chapter now reflects upon the evidence and analysis presented to reach some conclusions. The first section (9.1) refers to the meanings and interpretations of the going concern concept. The second section (9.2) refers to the way in which accounting has responded to changes in the economic, political and social developments. The third section (9.3) argues that the actions of the State are central to understanding the relationship between accounting and society. The fourth section (9.4) argues that the accountancy profession should not be seen as a homogeneous, neutral entity. The fifth section (9.5) refers to possible future research and the sixth (9.6) refers to the limitations of this thesis. Section 9.7 concludes the thesis with some final comments.

9.1: MEANINGS OF THE GOING CONCERN CONCEPT

The going concern concept does not have a single unambiguous meaning. It is multi-accented and has numerous competing meanings. The concept began to be described as 'generally accepted' in the USA in the 1930s, but it only received such descriptions in the UK in the 1970s. Historically, the concept has been associated with disucssions of bases of valuation and contents of the balance sheets. It has been used to justify adherence to original costs, depreciation, capital maintenance, focus on solvency, lower of cost and market value rule, market values, secret reserves, disclosure of various kinds, current cost accounting, constant purchasing power accounting, cash flow reporting, reject exit values and going concern values, etc. The concept has been used to perpetuate the view that a business has the prospect of a long/permanent life.

In the auditing context, explicit references to the going concern concept were relatively scarce prior to the 1970s. However, from the early 1970s, the concept began to attract greater attention. Its discussions tended to privilege the interests of finance capital. It implied that the auditors were concerned with reporting on business solvency, liquidity and survival. Towards this end, the auditors were expected to pay attention to company forecasts, budgets, plans, post balance sheet events, recoverability of assets, etc. After an initial indication that an auditor should 'actively' evaluate the applicability of the going concern assumption, the profession eventually recommended a 'passive' approach, requiring minimum audit effort.

The practitioners' felt that the concept had important implications for investors and creditors. They argued that they had little difficulty in assessing symptoms of going concern problems. However, whether a symptom was considered to be material, was dependent upon a combination of a number of factors. These related to the interests of finance capital, interests of directors, influence of education and the material interests of the auditors themselves. Some auditors were reluctant to accept some meanings of the concept, in case it widened their responsibilities and thus subjected them to a greater number of lawsuits. These related to a reporting role on market share, company plans and competitiveness. There were also some differences in the practitioners views. Most significantly, the smaller firms did not support the 'passive' approach favoured by the large firms and the Auditing Practices Committee (APC).

Through reflection upon the changing meanings of the going concern concept, a number of comments can be made about the relationship between accounting and society.

9.2: ECONOMIC SOCIAL AND POLITICAL DEVELOPMENTS

The meanings of the going concern concept have been shaped by social, political and economic changes. The influence of 'finance capital' is particularly relevant. The early accountants worked for financiers and bankers who were particularly concerned with the recoverability of the loans given to traders and manufacturers. In this context, they paid particular attention to solvency and liquidity of the businesses and going concern became synonymous with discussions of such factors. In times of economic recessions and falling prices, attention focused upon the valuation of current (easily realisable) assets and the rule of 'lower of cost and market value' became associated with the concept.

The 1930s economic and political crisis in the USA led to the institutional recognition of the concept as 'generally accepted'. However, this could only be understood by looking at the prevailing social environment. The American State was concerned with restoring confidence in the institutions of capitalism and business confidence in general. In this context, it encouraged faith in the economic reality captured by accounting numbers, by appealing to the going concern concept. Seemingly, the concept is a political weapon. The accountancy profession has appealed to the concept again and again to restore its own legitimacy. In the USA, the Accounting Principles Board (APB) and the Financial Accounting Standards Board (FASB) have referred to the concept a number of times to deflect criticisms. In the UK, in the 1970s the profession, when faced with a crisis, also appealed to the going concern concept to defuse criticisms of accounting and auditing.

The evidence suggests that there are differences in the accounting and auditing trajectories. The meanings in an auditing context were particularly shaped during times of economic crisis. These included a secondary banking crisis, property collapse, falling profitability, increasing liquidations, falling liquidity, pressures from the State, a crisis of legitimacy for the profession and lawsuits against major firms. The evidence suggests that during economic crises searching questions are asked of the adequacy of auditing practices. It is this questioning which provided the space for some meanings of the concept to become ascendent.

However, there is no simple way of predicting which meaning will become dominant.

The ascendancy of meanings is dependent upon control of institutions, resources and mobilisation of bias in the face of possible opposition (or co-operation) from 'significant others'. In order to manage the economic crisis of the 1970s, the State commissioned a number of company investigations. These were critical of auditing practices and suggested that the auditors ought to be paying particular attention to corporate survival, liquidity and solvency. However, the crisis which exposed the weaknesses of the auditing practices also paralysed the State. The State was unable to set-up an independent body to promulgate auditing standards. The responsibility for this passed to the profession. To gain mastery in discourse, the profession now accepted that going concern meant that "it was reasonable to expect the auditor to consider the future viability of his client" (APC, 1986, page 32). Having accepted this meaning, it did not, however, make concessions on what this implied for auditor responsibility and liability. It went on to legitimise a 'passive' approach to going concern. Legitimation for the 'passive' approach was achieved because the auditing wing - the most powerful wing of the profession - controlled the working party and the APC. It tailored the agenda and mobilised support for the auditing guideline.

9.3: THE STATE AND THE IDEOLOGICAL STATE APPARATUSES

In traditional accounting literature, the State's involvement in shaping accounting and auditing practices is hardly mentioned. However, this thesis found that the State's role is central in understanding the various meanings of the going concern concept.

The State nurtured the early accountancy profession through Royal Charters, bankruptcy and corporate legislation. In order to promote the long-term interests of capitalism, it encouraged investors to believe that businesses can expect perpetual or permanent life. In order to continue in business, the directors would assure investors of their propriety by giving a 'factual' account of the manner in which they utilised the resources. Thus 'costs' were promoted as evidence of 'facts' for a going concern. To remain in existence, the companies had to comply with the laws, such as those relating to control of profiteering. The State controlled profiteering by reference to 'costs'. By the early twentieth century, through practice, 'costs' became associated with going concern and entered the 'common sense' of accounting.

To remain 'going', businesses had to find resources to enable them to reproduce and transform themselves. For this purpose, depreciation was seen as a 'reserve fund' from which the companies could invest and maintain themselves as a going concern. The need for depreciation was legitimised by the State and the courts. Too much depletion of resources through payment of dividends could also threaten the survival of companies. The courts gave guidance on such problems and matters relating to dividends, solvency and liquidity came within the scope of the going concern concept. In an era of laissez-faire and 'caveat emptor', the State's policies respected the discretion of directors and permitted them to maintain 'secret reserves'. But when in the aftermath of the 1930s economic crisis, the public opinion and demands of the developing capital and finance markets required, the State exercised its 'relative autonomy' by removing such discretion.

The evidence presented here has shown that the accounting concepts should not just be seen as a technical phenomena. They are also political weapons. Appeals to the various descriptions and meanings help the State and related institutions to maintain a particular social order. For example, in the 1930s, the American State appealed to the going concern concept and its historical meanings. This was done to restore faith in corporate disclosures and the financial institutions. In the wake of the Wall Street crash and the ensuing economic decline, the concept helped to sustain the imagery of permanent or long lived enterprises and thus created confidence in institutional structures. The American profession also invoked the concept to sustain its own legitimacy. When in the 1970s the UK profession came under critical scrutiny, the profession appealed to the going concern concept to maintain its legitimacy. Each appeal was accompanied by a residue of historical meanings rather than the invocation of any new ones.

The State also had a decisive influence on the auditing side. It took increasing interest in accounting and auditing against a background of a severe economic crisis. In Britain this happened in the 1970s. In order to promote the long-term interests of capitalism, the State through the Department of Trade reports argued that 'going concern' means concern with solvency, liquidity and corporate survival. Such meanings were already in existence, for example, the early financiers focused on these aspects to judge the security of their investments. However, in professional circles, such meanings were not considered to be the major meanings. But now the State was giving prominence to such meanings. It argued that the auditors should acknowledge responsibility for reporting on such matters. The reports argued that the going concern concept meant paying attention to corporate forecasts, plans, budgets, liquidity, post balance sheet events, financial arrangements, correspondence with bankers, immediate economic environment and other aspects. It appears that during times of economic crisis, the State scrutinises the ability of accounting and auditing to construct and present what could be regarded as an independent, impersonal and objective reality.

The State was concerned with the long-term survival of capitalism and was prepared to go to considerable lengths to improve auditing practices. In addition to critical inspectors' reports, it issued lawsuits against auditors and forced the profession to acknowledge the importance of the going concern issues. In the mid 1970s, the State was paralysed by the economic crisis and was unable to create independent agencies to develop auditing standards and guidelines. But its actions, nevertheless, paved the way for the formation of the APC. This enabled the profession to assign greater weight to its preferred meanings to the going concern concept. Seemingly, a paralysis of the State creates opportunities for the profession.

9.4: PROFESSION

The official professional line is that "the auditor is rarely carrying out his work with the thought of subsequent litigation at the front of his mind" (APC, 1986, page 36). However, the evidence presented here shows the reverse to be the position. In order to formulate the auditing guideline, the working party, the APC and partners from major firms, were primarily aiming to reduce the incidence of litigation against auditors. The practitioners' approach to audit reports and interpretation of the symptoms of going concern was heavily influenced by the possibility of lawsuits. Further support for this view is presented by some additional evidence.

There was a chance meeting with some interviewees (partners in major firms) in 1990. The subjects remembered being interviewed on going concern issues and stated that they were now issuing a greater number of going concern qualifications. Whereas some symptoms were previously being interpreted as not significant, or immaterial to warrant the issue of a qualified audit report, now the same symptoms warranted a qualification. The subjects explained that their attitude has been changed by the Johnson Matthey settlement. In this case, Arthur Young made a £25 million out of court settlement in October 1988 and a further £24.25 million payment in February

1989 (Financial Times, 14th February 1989, page 6). The auditors now feared the possibility of further and massive claims and protected their position by issuing more going concern qualifications. The decision to issue more qualifications was also influenced by the onset of an economic recession where the auditors expected greater scrutiny of their craft and possibly more lawsuits. The evidence presented in Appendix 8 lends some support to the fact that in the aftermath of the Johnson Matthey settlement and the appearance of a recession, what previously did not constitute as a symptom of going concern began to be interpreted as such. Indeed, this thesis has argued that the meanings and implications of the concept cannot be understood without recognising that they are dependent upon the material interests of the practitioners. It would also appear that the practitioners' 'common sense' interpretations are shaped by contemporary episodes which threaten their economic interests. The extent to which these leave any lasting inventory is a matter for future research.

The meanings advanced by the profession and the formulation of the auditing guideline shows that the profession is concerned with promoting 'sectional interests'. The profession responded to the crisis of lawsuits by legitimising a 'passive' approach to going concern. This made minimal demands on audit effort, yet strove to give auditors considerable protection from lawsuits. In time, the contradictory nature of the guideline may result in criticisms of the profession by 'significant others'. The auditing guidelines are also important in that they are used as 'benchmarks' in DTI investigations and are influential in court cases.

The evidence presented here suggests that the auditing wing (and major firms) has a greater voice in the shaping of accounting discourses. In view of its power and influence of the auditing wing, a body to promulgate auditing standards was not set up at the time of the creation of the ASC. However, when the mid 1970s banking and property crisis exposed the deficiencies in the auditing practices, the profession responded by setting up the APC, entirely under the control of the auditing wing. The major firms facing lawsuits and public criticisms came to control the APC and articulated an auditing approach most beneficial to them. The meanings of going concern were not derived from any systematic research, but were shaped by the views of a relatively few well connected partners. One may find similar influences in studies of auditing policymaking in other areas.

Following the evidence of this thesis, the profession should not be seen as a homogeneous entity. It consists of groups with possibly conflicting interests. Industrial/Commercial accountants did not have any say in the formulation of the guideline. Small practitioners were rarely consulted. They indeed, disagreed with some aspects of the guideline, most notably the recommendation of the 'passive approach'. In view of the evidence presented, a plea is also made for a critical scrutiny of the term 'profession'. The phrase carries notions of expertise, knowledge base, ideals of service and many other meanings. Such images of the profession do not help in appreciating the fact that accountancy firms are a 'fraction of capital'. They have common and competing interests which bring them in conflict with other fractions of capital, as evidenced by a large number of lawsuits and DTI reports. The firms try to win the most favourable social environment to enable them to compete, control markets and enjoy profits, growth and economic rewards. It is such pressures, which made the auditing firms prefer a 'passive' approach and reject auditor responsibility for reporting on cash flows, market shares and company competitiveness. The firms also have competing interests as highlighted by the different interpretations of the going concern concept. By recognising the existence of a fractionated profession and acknowledging that accountancy firms are a fraction of capital, this thesis has been able to show the nature of the 'interests' which are being advanced as the meanings of the going concern concept.

9.5: FUTURE RESEARCH

The 'passive' approach to going concern is also enshrined in the American standard and the guideline issued by the International Auditing Practices Committee in 1986. Chapters 5 and 7 have already noted the influence of American accounting developments on Britain. It would be useful to perform a cross-national study to see whether the American and International auditing guidelines are also the result of the pursuance of sectional interests, dominance of major firms and economic crisis.

In recent years, regulators have argued that accounting standards ought to be underpinned by accounting concepts. This debate begs some important questions: What exactly do the concepts mean and which meanings are to be regarded as dominant? Such questions have rarely been considered by the profession. Upon investigation, this thesis found that going concern does not have a fixed meaning and in view of the nature of concepts and society, cannot have a fixed meaning. The articulation of meanings is a political activity, which in appropriate circumstances gives ascendancy to some power blocs, discourses and meanings. The methodological framework advanced in this thesis would be helpful in exploring the competing meanings of other fundamental accounting concepts.

The debates about the meanings of going concern are also debates about the meaning of an audit. Here the profession blames the 'expectations gap' for its criticisms and litigation. The framework of this thesis may help in understanding the dominant meanings of an audit and the manner in which profession might periodically accept some meanings to enable it to reconstruct its identity. The changing meanings may also be linked to economic and social developments.

Following the framework of this thesis, it would be helpful to explore the extent to which auditing standards and guidelines have been shaped by the actions of the State, or the influence of powerful elites within the profession. Are the auditors always interpreting accounting discourses and auditing guidelines with issues of liability at the forefront or was the case of going concern an exception?

9.6: LIMITATIONS

It is also appropriate to reflect upon the methodological framework of this thesis. Its strength has been that it helped to see accounting in a social context. The going concern concept, rather than just being a technical phenomena, was seen as being shaped by a variety of institutions and events. Each being enabled and constrained by the sociopolitical contexts. One of the major criticisms of this thesis may be that it has attached too much weight to the 'economic' factors in understanding the relationship between accounting and society. It is possible that the economic, social and political spheres move according to their own rhythm and only when they come together in some sustained way that meanings of accounting are transformed. In the USA, the stock market crash, the economic decline and a presidential election coincided to give legitimacy to the going concern concept. In the UK, concerns with reviving the economy, restoring confidence in financial markets, press criticisms of the profession and a legitimation crisis for the State, seemingly coincided to transform the meanings of the concept. It has not been possible to suggest the kind of factors which must coincide in some appropriate weights to provide an opportunity for transforming the meaning of accounting concepts. It is possible that cultural, organisational and other influences may also have shaped the meanings of the concept. However, this is an empirical question which can only be addressed through further research.

With a positivist conception of social science, there may be an expectation that research will help to produce testable hypothesis and predictions. Therefore, in common with much of the social sciences, this thesis may well be criticised for only offering explanations and understanding of the way accounting is shaped by a wide variety of events. However, such understanding emancipates and offers opportunities for change.

9.7: CONCLUSION

This thesis examined the relationship between accounting and society by focusing upon the changing meanings and interpretations of the going concern concept, thought to be 'fundamental' in accounting and claimed to be 'material but not fundamental' in auditing. In view of the conflict and contradictions of a capitalist society, the meaning of accounting practices cannot be finally fixed. The thinking on accounting and auditing will continue to be informed by a sedimented residue of 'common sense', upon which new layers will be added. Such layers will result from the competing meanings of the concept and struggle for ascendancy. During times of acute crisis, the profession will be forced to rearticulate a preferred meaning to protect the interests of its dominant members. The meanings of accounting and auditing concepts do not develop in any unproblematic way. In this context, the methodological framework relying upon mainly Marxist thinking helped in understanding the contested nature of the concept, the role of the economic sphere, privileged groups and the State.

APPENDIX 1

QUESTIONNAIRE SENT TO AUDITORS:

AUDITOR AND GOING CONCERN DECISIONS

Questionnaire: Auditor and Going Concern Decisions

SECTION A

Please indicate your attitude towards each statement by circling the number which approximates your attitude.

Following is a key to the numbers.

1 = Strongly disagree, 2 = disagree, 3 = Unsure 4 = agree and 5 = Strongly agree

Going-concern qualifications cause a negative share price reaction in the client company's share price.	1	2	3	4	5
Going-concern qualifications alert institutional investors to uncertainties inherent in the financial statements.	1	2	3	4	5
Going-concern qualifications alert individual investors to uncertainties inherent in the financial statements.	1	2	3	4	5
Going-concern qualifications alert creditors to uncertainties inherent in the financial statements.	1	2	3	4	5
Going-concern qualification is of no consequence.	1	2	3	4	5
A going-concern qualification is likely to increase the client's financial problems.	1	2	3	4	5
A client experiencing going-concern problems should be given more time by the auditor.	1	2	3	4	5
Going-concern qualification is likely to precipitate the client company's failure.	1	2	3	4	5
A Going-concern qualification is very likely to increase client's cost of obtaining finance.	1	2	3	4	5
Going-concern qualifications give bad publicity to your firm.	1	2	3	4	5
Going concern qualifications are a reflection on the management's abilities	1	2	3	4	5

A decision to issue a going-concern qualification enhances your firm's credibility.	1 2 3 4 5
An unqualified audit report indicates that in the auditor's opinion the business is financially viable.	1 2 3 4 5
A decision to issue a going-concern qualification increases the likelihood of your firm losing that client.	1 2 3 4 5
A decision to issue going-concern qualification increases the likelihood of your firm losing potential clients.	1 2 3 4 5
A going-concern qualification will increase the likelihood of a law-suit against your firm.	1 2 3 4 5
Auditors should be required to alert the investors on the likelihood of company insolvency.	1 2 3 4 5
Auditors should take active steps to satisfy themselves that the business remains competitive in the forseeable future.	1 2 3 4 5
Auditors should take active steps to satisfy themselves that the business retains its market share.	1 2 3 4 5
Auditors should not be required to analyse the company's financial plans.	1 2 3 4 5
The auditor should take active steps to satisfy himself/herself that an enterprise is a going-concern.	1 2 3 4 5
The auditor is in no better position than the financial statement user to predict the resolution of uncertainties.	1 2 3 4 5
The auditor should explain to the users, how he/she made his/her going concern decisions	1 2 3 4 5
If the companies publish cash flow forecasts then the auditors should be required to report on them.	1 2 3 4 5
Going-concern qualifications are not very informative.	1 2 3 4 5

If financial statements disclose all material uncertainties, then the auditor should not issue a going-concern qualification.	1 2 3 4 5
'Disclaimer of opinion' should be the most appropriate form of audit qualification for going concern problems.	1 2 3 4 5
'Subject to' audit reports are the most appropriate for going-concern qualification	1 2 3 4 5
Users do not understand the significance of a going-concern qualification.	1 2 3 4 5
For a non-going concern, auditors do not have the know how to ascertain the recoverable value of assets.	1 2 3 4 5
The auditing guideline gives the impression that the auditor is giving assurances on the financial viability of the company audited.	1 2 3 4 5
The auditing guideline has strengthened the auditor's ability to withstand pressure from management.	1 2 3 4 5
The auditing guideline has increased the possibility of a law-suit against your firm.	1 2 3 4 5
The auditing guideline has increased the likelihood of you issuing a going-concern qualification.	1 2 3 4 5
We are likely to issue more going concern qualifications now.	1 2 3 4 5
The APC guideline is of little use to my firm	1 2 3 4 5
The APC should develop an auditing guideline indicating the techniques useful for making going-concern decisions.	1 2 3 4 5
The APC guideline has increased the audit costs	1 2 3 4 5

SECTION B

Shown below is a list of some approaches used to help identify and evaluate going-concern problems. Please indicate the importance which you have attached to each of the approaches in your actual decisions, by weighting each approach from 0%-100%. <u>Please ensure that the sum total of the weights adds up to 100%.</u>

<u>Approach</u>	<u>Weight</u>
Accounting ratios	______
Graphs	______
Z Score Models	______
Company forecasts	______
Other (please specify)	
______________________________	
______________________________	
______________________________	
______________________________	
______________________________	
______________________________	
______________________________	
	100%

In connection with the approaches identified above, how many years data do you examine?

What is the minimum information which you need to identify going concern problems?

Cont'd

Has the auditing guideline changed your firm's procedures in any way?

[ ] Yes [ ] No

If yes, please indicate how.

Who identifies going-concern problems in your firm?

Who makes the decision to issue going-concern qualifications in your firm?

What is your interpretation of the term 'foreseeable future'? Please indicate the reasons for your interpretation.

Do you have formal written policies for issuing going concern qualifications? Please explain.

Do you require your clients to prepare financial plans for the forseeable future?

[ ] Yes [ ] No

What do you do if the client company does not have a cash forecast to cover the foreseeable future?

Cont'd

What in your opinion is the purpose of a going concern qualification?

What are your reservations about the auditing guideline?

<u>If you use accounting ratios to identify going-concern problems, please indicate the importance which you attach to each of the following ratios by circling the appropriate number.</u>
<u>For this question only, 1 = of no importance, 2 = of very little importance 3 = of moderate importance 4 = important, and 5 = Very important</u>

Working capital/total assets	1	2	3	4	5
Working capital/net sales	1	2	3	4	5
Net income/ net sales	1	2	3	4	5
Current assets/total assets	1	2	3	4	5
Current assets minus stock /current liabilities	1	2	3	4	5
Current assets/current liabilities	1	2	3	4	5
Current assets/total liabilities	1	2	3	4	5
Current assets/net sales	1	2	3	4	5
Creditor Turnover	1	2	3	4	5
Retained earnings/total assets	1	2	3	4	5
Current liabilities/total assets	1	2	3	4	5
Total debt/total assets	1	2	3	4	5
Net income/total assets	1	2	3	4	5
Stock Turnover	1	2	3	4	5
Shareholders' funds/ fixed assets	1	2	3	4	5

<u>Cont'd</u>

Profit before tax/current liabilities	1 2 3 4 5
Earnings before interest and taxes/ total assets	1 2 3 4 5
Operating profit before interest and taxes/interest expense	1 2 3 4 5
Cash/total assets	1 2 3 4 5
Operating profit before taxes/total tangible assets	1 2 3 4 5
Operating profit/shareholders' funds	1 2 3 4 5
Total liabilities/shareholders' funds	1 2 3 4 5
Debtor Turnover	1 2 3 4 5
Cash flow/total debt	1 2 3 4 5
Common equity/ total debt	1 2 3 4 5
Market value of equity/book value of total debt	1 2 3 4 5
Sales/total assets	1 2 3 4 5

<u>In the space below please add any other accounting ratio(s) which you use and indicate the relative importance on a scale of 1 to 5.</u>

____

____

____

____

<u>SECTION C: Details about your firm</u>

The following information is being asked, so as to enable me to analyse the responses.

Please indicate your job title.

When did you qualify?

How many years auditing experience do you have?

Cont'd

Has your work ever required you to identify going-concern problems?

[ ] Yes [ ] No

Have you ever issued a going-concern qualification ?

[ ] Yes [ ] No

How many qualified accountants are employed in your particular office ?

Please indicate the number of partners in your firm.

If you would like to receive a summary of this research, please write your name and address below.

In the event of a query may I contact you.

[ ] Yes [ ] No

If yes, please provide your name and telephone number.

Thank you very much for completing the questionnaire. Please return it to me in the envelope provided.

APPENDIX 2

COVERING LETTER ACCOMPANYING THE QUESTIONNAIRE

North East London Polytechnic
Longbridge Road, Dagenham, Essex RM8 2AS

Accountancy Research Group
G A Curtis MA MSc MPhil
C F Horner BSc(Econ) MSc FCMA FCCA
P Sikka MSc FCCA

Telephone:
01-590 7722
Ext. 2236

Dear Mr. ,

I am currently researching into the auditor's consideration and evaluation of going-concern problems. My intention is to compare the auditors' and the directors' views and draw the differences, if any, to the attention of those interested in auditing. There is no prior UK study of this type.

I appreciate that as a practising accountant you have very little spare time, but I hope that you will find the questions on the next few pages thought provoking. The enclosed questionnaire was compiled after extensive discussions with auditors and directors. It will take you about thirty minutes to complete the questionnaire.

The practitioners participating in research often complain that they never see the results of that research. This is a problem which I would like to avoid. Therefore, if you would wish to receive a summary of the findings, I would be very happy to oblige. This would give you a unique opportunity to compare your answers with those from other firms.

Please return the completed questionnaire to me in the enclosed prepaid envelope. I look forward to hearing from you and would stress that your reply will be treated in the strictest confidence.

Yours sincerely

P. Sikka

APPENDIX 3

ACCOUNTING RATIOS BELIEVED TO BE USEFUL IN MAKING GOING CONCERN DECISIONS

APPENDIX 3

ACCOUNTING RATIOS FOUND TO BE USEFUL IN AUDITOR AND GOING-CONCERN DECISIONS

Ratios	Study 1	2	3	4	5	6
Working capital/ total assets	X					
Working capital/ net sales				X		
Net income/ net sales					X	
Current assets/ total assets				X		
Current assets minus stock/current liabities		X	X	X		
Current assets/ current liabilities		X		X	X	
Current assets/ total liabilities						X
Current assets/ net sales				X		
Retained earnings /total assets	X			X		
Current liabilities/ total assets						X
Total debt/total assets				X	X	
Net income/total assets			X		X	
No-credit interval						X
Current year cash flow/total debt				X		
Profit before tax/ current liabilities						X
Earnings before interest and taxes /total assets	X			X		

	1	2	3	4	5	6
Operating profit before interest and taxes/interest expense		X				
Cash/total assets			X			
Operating profit before taxes/total tangible assets		X				
Operating profit/ shareholders' funds		X				
Total liabilities/ shareholders' funds		X				
Net worth/total debt			X		X	
Cash flow/total debt					X	
Common equity/ total debt				X		
Market value of equity/book value of total debt	X					
Sales/total assets	X		X	X		

Notes

1. Altman and McGough (1974): Use of discriminant models to show that the model can outperform man.

2. Campisi and Trotman (1985): Ratios which produced auditor consensus.

3. Kida (1980): Ratios with predictive power according to the discriminant models.

4. Levitan and Knoblett (1985): Ratios with some predictive power according to the discriminant models.

5. Mutchler (1984): Ratios considered to be important by the auditors.

6. Taffler and Tisshaw (1977); Taffler and Tseung (1984). Both studies use discriminant models to identify ratios which outperform auditors' judgement.

APPENDIX 4

PRICE LEVELS 1851-1913

Appendix 4

PRICE LEVELS 1851- 1913

Year	Wholesale Prices Index (a)	Cost of Living Index (b)
1851	91	-
1852	92	-
1853	112	-
1854	120	-
1855	119	-
1856	119	-
1857	124	-
1858	107	-
1859	111	-
1860	116	-
1861	115	-
1862	119	-
1863	121	-
1864	124	-
1865	119	-
1866	120	-
1867	118	-
1868	116	-
1869	115	-
1870	113	-
1871	116	-
1872	125	-
1873	130	-
1874	126	-
1875	121	-
1876	118	-
1877	121	-
1878	113	-
1879	107	-
1880	111	-
1881	109	-
1882	110	-
1883	108	-
1884	98	-
1885	92	-
1886	87	-
1887	85	-
1888	87	-
1889	89	-
1890	89	-
1891	92	-
1892	87	93
1893	85	89
1894	80	85

1895	78	83
1896	76	82
1897	77	86
1898	80	89
1899	79	85
1900	86	90
1901	83	90
1902	83	91
1903	83	92
1904	84	92
1905	84	92
1906	87	91
1907	91	94
1908	88	96
1909	89	96
1910	93	98
1911	94	98
1912	99	103
1913	100	103

(a) Assumes 1913 = 100.

(b) Assumes Jan-July 1914 = 100.

Source: Mitchell and Deane (1962).

APPENDIX 5

A MEMORANDUM SHOWING EARLY CONSIDERATION OF GOING CONCERN ISSUES BY ACCOUNTANCY FIRMS

BACKGROUND TO PROBLEMS

1.1 The liquidity crisis -

Effect of inflation, made worse by

(i) high interest rates,
(ii) over borrowing,
(iii) high commodity prices,
(iv) high wage claims and related employee benefits (such as pensions), and
(v) an inability to pass on costs by price restraints and profit margin restrictions.

Affects large and small business - from British Leyland/Burmah Oil to shopkeepers/farms. Varying degrees depending on which factor is dominant, e.g. property companies hit by high interest rates, retailing by price controls, and heavy industry by raw material costs.

Taxation policies added to problem; increase of rate of corporation tax from 50% (equivalent to 40% under old system) to 52% and ACT .

. Stock relief gave correction by releasing £750m/£1,000m back to the private sector.

1.2 The Accountants' involvement -

As professional adviser, director, management consultant, "friendly neighbourhood auditor", or potential receiver.

As participators in formulating accounting techniques -

i.e. SSAP 2		Accounting policies (with particular reference to "going concern" concept).
SSAP	10	Source and application of funds statements.
ED	24	Accounting for inflation.

As auditors - awareness of responsibilities to creditors as well as shareholders and willingness to qualify where necessary.

1.3 Directors' responsibilities -

Continuation of business as a going concern is responsibility of directors, not auditors.

Quite legal for directors to make losses in company, but possible misfeasance if effect is to prejudice company and shareholders. S.332 of C.A. 1948 could involve directors in personal liability on a liquidation. Now being extended by E.E.C. Convention on Bankruptcy which may involve any manager of a company which has gone backrupt in personal liability.

Uncertain position where Government is involved, except where it is a clear-cut Government grant. Examples of U.C.S. and "Beagle-type" responsibility, Court Line hiatus, and Bank of England "lifeboat" committee - all areas of implied support and where an auditor might assume aid which may not in the event be forthcoming.

AUDITING APPROACH

2.1 Necessary to determine whether company is going concern before assuming basis of valuing assets and liabilities. If not - disclose. Where doubt or disagreement remains, qualification necessary.

2.2 Is it a going concern? Now necessary to determine answer to this on each and every occasion for all clients. Requires review of -

(a) current situation,
(b) future cash flow,
(c) availability of resources.
(d) consider borrowing power.

2.3 Review of current situation embraces -

(a) consideration of source and application of funds of recent period to ascertain trend;

(b) net current liability position and in particular debtor/creditor ratio;

(c) amount of short term borrowings including bank overdrafts;

(d) amount of fixed term borrowings falling due for repayment;

(e) are long term assets financed by short term finance?;

(f) dependance on a limited spread of business, or reliance on a few customers, suppliers or products;

(g) pattern of paying creditors;

(h) pattern of settlement by customers of amounts receivable;

(i) legal actions or political action, e.g. sit in;

(j) new business development (over trading);

(k) government or economic circumstances.

2.4 Review of future cash flow -

Normally statements available but if not, usually capable of being drafted quickly - necessary discipline for businesses of all sizes. Extension of judging the future, e.g. stocks, depreciation. Necessary to cover 12 months in some detail (monthly), but no longer possible merely to restrict review to 12 months and disregard future beyond that. Certain situations also require special consideration beyond 12 months -

(a) where review takes place long after year end;

(b) where business cycle extends beyond 12 months, e.g. construction contracts;

(c) ongoing loss situation;

(d) repayment of borrowings not evenly spread

Review budgets and cash flow in normal way, although in lesser detail than profit forecast situation unless evident that it is in critical position. Note that assumptions used cannot be stated (unless critical) so acceptability must be judged by auditor only and not reader of accounts. In particular consider reasonableness of -

(a) forecast profits;
(b) level of stocks, debtors and creditors;
(c) projected capital expenditure;
(d) other capital financing;
(e) effect of inflation.

2.5 Consider availability of resources -

(a) short term borrowings - agree direct with the bank facilities available and their review date.
(b) longer term borrowings - repayment dates and ability to replace with further borrowings;
(c) government grants;
(d) additional share or loan capital, e.g. rights issue;
(e) mortgaging specific assets, including factoring of debts and hire purchase of fixed assets;
(f) sale and leaseback of properties or outright sale of surplus assets, e.g. investments.

2.6 Consider borrowing powers -

May be laid down in Articles or Deeds. Often margin required and therefore there may be "technical" default without actual insolvency; particularly after major loss affecting capital and reserves.

Impact of "technical" default may be as serious -

e.g. Burmah Oil Directors' statement of December 31st 1974 said

"As a result of the anticipated trading results for the year, the Company expects that it will not be able fully to comply with certain provisions of loan agreements with the bankers under which foreign currency loans amounting to £650m have been advanced to the Group ....."

and amplified on January 1st 1975

"Reference to the fact that the Company might not be able fully to comply with certain provisions of foreign currency loan agreements is related specifically to aspects of the covenants and ratios associated with such agreements and does not in any way imply inability on the part of the Company to pay due amounts either of principal or interest".

3. WHAT HAPPENS IF ALL IS NOT WELL?

3.1 May mean partial curtailment of business requiring that part to be valued on a "break up" basis with provision for future costs of redundancy and other losses. Comment required in directors' report (state of business) and reference in accounting policies notes (as going concern concept not wholly applied). No reference required in audit report if there are no material uncertainties.

3.2 Uncertainty remaining, e.g. negotiations for alternative or additional finance still in hand. Valuation of assets on a going concern basis justifiable but necessary for reference to be made in auditors report to uncertainty.

Example (i) where there is a reasonable chance of success -

"We have examined the accounts set out on pages - to -.

The accounts have been prepared on a going concern basis, the validity of which is dependent on the successful conclusion of current negotiations for additional finance. In the absence of this finance, the going concern basis would be invalid and provision would have to be made for any loss on realisation of the Company's assets which might arise.

In our opinion, subject to the successful conclusion of the negotiations referred to above, the accounts give a true and fair view of the state of the company's affairs at .... and of its profit for the year ended on that date and comply with the Companies Acts 1948 and 1967".

Example (ii) - where there is doubt as to whether finance will be available -

"We have examined the accounts set out on pages - to -.

The accounts have been prepared on a going concern basis the validity of which is dependent on the company obtaining further finance. In the absence of such finance, this basis would be invalid and provision would have to be made for any loss on realisation of the company's assets which might arise.

We are unable to satisfy ourselves that further finance will be forthcoming and accordingly, we are unable to form an opinion as to the validity of the use of the going concern basis and, therefore, whether the accounts give a true and fair view of the state of the company's affairs at .... and of its profits for the year ended on that date.

In our opinion, the accounts comply in all other respects with the requirements of the Companies Acts 1948 and 1967".

3.3 Where it is not possible to determine whether there is a need (e.g. no cash forecasts at all), then doubt must be expressed as to the basis of adopting the going concern concept and consequent valuation of assets.

Example (iii) -

"We have examined the accounts set out on pages - to -.

The accounts have been prepared on a going concern basis but in the absence of adequate information concerning the company's future cash requirements, we are unable to form an opinion as to the validity of the use of this basis.

For this reason we are unable to form an opinion whether the accounts give a true and fair view of the state of the company's affairs at .... and of its profit for the year ended on that date.

In our opinion, the accounts comply in all other respects with the requirements of the Companies Acts 1948 and 1967".

4. OTHER IMPLICATIONS

4.1 Danger of "self-fulfilling prophecy", but auditors have specific responsibilities which cannot be abrogated. Increasing likelihood of legal action against auditors, including possibility of class actions. Directors should comment more in their annual report and in interim announcements - both half yearly and others.

4.2 Watch post-balance sheet events and consider their implication on any changes in liquidity. Make audit reports as close to completing the job as practicable.

4.3 Be aware of conflicting pulls of PSSAP 7 and ED 13.

Major defect in PSSAP 7 is the inclusion of gain on borrowings which makes very highly geared companies appear to be more successful under CCP accounting than others - yet they are most likely to go bust.

4.4 If a qualification is necessary, refer to outcome in following year. Argument for 2 year report but at least cover any earlier qualification.

4.5 Questions asked of an auditors involvement.

When does an auditor resign? Does he make his doubts public (for a listed company)?, can he require directors to convene an E.G.M. to inform shareholders of position? Should he tell other parties, e.g. Bank of England, in the case of a bank, Department of Trade, in the case of an insurance company?

CONCLUSION

5.1 Very difficult area involving judgment.

5.2 Must be considered and documented in audit files now as standard routine with work performed and conclusions set out.

5.3 No longer possible to assume extension of credit and therefore where doubt exists, report should state position.

5.4 Ensure that what is said in audit report enables reader to judge position properly.

APPENDIX 6

A LETTER SHOWING THAT THE APC BALLOTED ITS MEMBERS FOR THE APPROVAL OF THE GOING CONCERN GUIDELINE

AUDITING PRACTICES COMMITTEE
P.O. Box 433,
Moorgate Place,
London EC2P 2BJ

Tel: 01-628-7060

Our Ref: AR/RC/PJW APC 12-39P

TO: All members of the
Auditing Practices Committee

23 April 1985

DRAFT AUDITING GUIDELINE:
THE AUDITOR'S CONSIDERATIONS IN RESPECT OF GOING CONCERN

I enclose a copy of the above draft auditing guideline which was approved by APC at the meeting on 25 March 1985. Amendments which have been made since that date are identified by barlines.

The principal amendment is to the example of a qualified audit report (paragraph 28). This has now been expanded so that all the material matters giving rise to the qualification are referred to in the report. In particular, the basic facts concerning the negotiation of vital financing arrangements are now stated.

I enclose also a ballot paper for approval for publication of the guideline. Please will you complete this and return it to me by 7 May 1985.

Alun Richards

Alun Richards
Secretary

Enc.

APPENDIX 7

A CHECKLIST USED BY A MAJOR MULTINATIONAL FIRM FOR MAKING GOING CONCERN EVALUATIONS

FINANCIAL REVIEW CHECKLIST

B/

Audit of........................ Date of Accounts................

Completed by.................... Date............................

Notes:

(1) The questions in paragraphs 1 to 24 below provide examples of the more common matters which should be considered by the audit manager in his review of the overall financial position of audit clients (Audit Completion Programme Q2). They are phrased in broad terms and may often be used as an aide-memoire in a general discussion of the company's affairs with management. Additional matters may be appropriate on individual audits.

(2) Unsatisfactory matters should, if significant, be brought to the attention of the partner on MAPs.

	REMARKS

General

1. Are there any special factors affecting the company's trade, on which the partner should be informed?

2. Is the company sufficiently aware of the effects of inflation on its operations?

3. Is the company's business being restricted by price control legislation? If so, is there proper planning to minimise any such restriction.

4. Has the company taken advantage of all government grants that may be available to it?

Operating Performance

5. Broadly, what are the reasons for increased or decreased sales, profits and general activity in the current year as compared with the previous year?

6. Are there any industry comparison statistics for the trade in which the company is engaged? If so, are steps being taken by the company to compare its own results and productivity with that of similar companies by means of such factors.

7. If the company has incurred significant losses in any of the following areas, is improvement required in the company's management or administration?

(a) Stock provision for deterioration, obsolescence, slow movement or shortfall in net realisable value.

REMARKS

(b) Stocktaking difference. Would the company benefit by the introduction or extension of continuous stocktaking?

(c) Bad and doubtful debts.

(d) Obsolete fixed assets.

(e) Decrease in market value of investments.

(f) Losses from individual activities, branches or subsidiaries.

Accounting and Administration

8. Is there any scope for computerising or otherwise modernising the company's accounting records?

9. Do variances in actual results for the year under review from those budgeted indicate that budgeting procedures need improving?

10. Has the audit indicated any areas in which the management information might not be adequate?

11. Is the financial information received by the Board of Directors adequate? In the context of this question the following matters should be considered:-

(a) The regularity and frequency of Board reports.

(b) The form and content of Board reports (including management accounts and comparison of performance against budgets).

(c) The extent to which the Board receives information in connection with subsidiaries, including overseas subsidiaries.

(d) Whether the Board is made aware of 'off balance sheet' items (e.g. management and performance of pension funds, extent of guarantees, level of discounted bills and similar commitments).

12. Is the parent company control over group accounting arrangements satisfactory, in respect of both UK and overseas subsidiaries? In particular:-

(a) is the head office satisfied as to the quality of accounting staff in subsidiaries?

(b) is a group accounting manual necessary or, if a manual exists, could its scope be usefully extended, does it need updating, or could it be improved in any other way?

REMARKS

(c) is there sufficient direct control by head office to ensure that:-

(i) accounting disciplines are satisfactory;

(ii) group accounting policies in difficult areas are properly followed?

(d) are management accounts from subsidiaries accurate and prepared on time? If not, does the head office take action?

13. If there is no internal audit department, should there be one?

14. If there is an internal audit department:-

(a) are its terms of reference adequately defined?

(b) is it properly independent of operational management?

(c) is it adequately staffed by personnel of the proper quality?

(d) is the quality of its reports adequate?

(e) are its reports received by the right people, and acted upon?

15. Have there been any transactions likely to infringe the objects clause?

16. Has the audit indicated any other weaknesses that it might be convenient for the partner to discuss with the directors?

Financing Arrangements

17. Is the company having to finance excessive amounts of working capital? In particular:-

(a) is the company carrying excessive stocks?

(b) are debts being collected sufficiently promptly?

(c) is the company taking full advantage of credit terms offered by suppliers of goods and services?

18. Is the company having difficulty in obtaining sufficient funds to finance its working capital?

19. Taking the company's overall structure and position into account, is there any imbalance in methods of finance between equity, long term loans, and short term finance?

REMARKS

20. Is there any indication that the cost to the company of loan finance is excessive and, if so, could any recommendations be made for refinancing the company more advantageously?

Future Plans

21. Has the company any proposals for significant expansion? (This matter should be considered in the light of the company's budget for the next year.) If so:-

(a) is any difficulty anticipated in financing, for instance, fixed asset additions, acquisitions of businesses, or increased working capital?

(b) do the management resources appear adequate in the light of the proposed expansion?

Pensions

22. Is there an adequate pension scheme for directors and staff?

23. Has the company any pension obligations, legal or moral, which might not be adequately funded?

Insurance Cover

24. Has the insurance cover on the buildings, plant, stock and other assets and for loss of profits been recently reviewed to ensure that it is adequate?

APPENDIX 8

RATES OF GOING CONCERN CONCERN QUALIFICATIONS

APPENDIX 8

RATES OF GOING CONCERN QUALIFICATIONS

PERIOD	RATE OF GOING CONCERN QUALIFICATIONS
May 1984	3.0%
June 1984	4.0%
July 1984	4.0%
August 1984	4.0%
September 1984	4.0%
October 1984	3.0%
November 1984	4.0%
Jan 85/Dec 1984	4.0%
February 1985	3.4%
March 1985	3.9%
April 1985	N/A
May 1985	N/A
June 1985	2.6%
July 1985	3.5%
August 1985	4.8%
September 1985	5.0%
October 1985	3.1%
November 1985	3.8%
December 1985	3.6%
January 1986	5.1%
February 1986	4.5%
March 1986	5.3%
April 1986	4.4%
May 1986	4.6%
June 1986	4.3%
July 1986	4.5%
August 1986	4.7%
September 1986	4.5%
October 1986	5.3%
November 1986	4.9%
December 1986	4.5%
January 1987	4.8%
February 1987	3.8%
March 1987	4.9%
April 1987	4.1%
May 1987	3.9%
June 1987	4.5%
July 1987	4.0%
August 1987	3.1%
September 1987	4.5%
October 1987	3.6%
November 1987	4.8%
December 1987	4.3%
January 1988	4.1%
February 1988	3.7%
March 1988	4.4%
April 1988	4.7%
May 1988	3.6%
June 1988	4.8%
July 1988	3.6%

August 1988	4.5%
September 1988	5.9%
October 1988	4.4%
November 1988	4.1%
December 1988	5.1%
January 1989	4.6%
February 1989	3.9%
March 1989	5.1%
April 1989	N/A
May 1989	10.0%
June 1989	12.0%
July 1989	11.0%
August 1989	12.0%
September 1989	12.0%
October 1989	15.0%
November 1989	9.0%
December 1989	13.0%
January 1990	13.0%
February 1990	14.0%
March 1990	12.0%
April 1990	19.0%
May 1990	14.0%
June 1990	13.0%
July 1990	21.0%
August 1990	19.0%
September 1990	18.0%
October 1990	16.0%
November 1990	15.0%
December 1990	27.0%
January 1991	25.0%

Source Various editions of The Audit Report.

The rates are affected by the size of the samples.

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