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**ABSTRACT:** The FASB’s new going concern standard requires the management of an entity to formally assess the entity’s ability to continue as a going concern and disclose if management has substantial doubt about such for the coming year. Using juror decision-making experiments, we investigate the effect of the new standard and management disclosure on auditor blame and negligence assessments. We find that, when management has not disclosed going concern issues, jurors attribute more blame to auditors for investor losses and increase auditor negligence verdicts under the new FASB standard compared to the previous reporting environment. Additionally, we find that under the standard, auditor blame further increases when management has disclosed going concern issues. Given these findings, we investigate how including a CAM about the auditor’s going concern assessment impacts juror judgments. We find that including a CAM substantially decreases auditor blame and negligence verdicts, which is fully mediated by perceptions of auditor diligence with respect to their going concern duties. These findings shed light on the impact of both new financial accounting and audit reporting standards on auditor liability, which should appeal to a broad audience including regulators, practitioners, and academics.

**Keywords:** ASC 205-40/ASU 2014-15, going concern, auditor liability, blame, negligence
I. INTRODUCTION

Independent auditors have long been required to assess an entity’s ability to continue as a going concern and, if substantial doubt exists, include an explanatory paragraph in the audit report describing the conditions or events that give rise to that doubt (PCAOB 2016; AICPA 2018). Until recently, financial reporting standards imposed no specific responsibility on the management of an entity to evaluate going concern issues, and financial statement disclosure of any such issues were required only under certain circumstances. Financial statement preparers and users felt that “the varying interpretations of when and how going concern uncertainties should be disclosed under the auditing standards result[ed] in diversity in the timing, nature, and extent of existing footnote disclosures” (FASB 2013). As a result, in 2014, the FASB released Accounting Standards Update (ASU) No. 2014-15, which created Accounting Standards Codification Subtopic 205-40: Presentation of Financial Statements – Going Concern (ASC 205-40). This new financial accounting standard requires management to separately conduct a formal going concern analysis, disclose if there is substantial doubt about the entity’s ability to continue as a going concern, and also disclose plans to mitigate the substantial doubt, if possible (FASB 2014, 2016).\(^1\) ASC 205-40 became effective for financial statements for annual and interim periods ending after December 15, 2016, and the practicalities and implications of adopting this standard are not yet well understood.

Although the FASB’s intention when promulgating ASC 205-40 was to reduce misunderstanding, ironically, application of this standard could result in additional confusion for

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\(^1\) Ponemon and Raghunandan (1994) state that the term “substantial doubt” constitutes a likelihood of 50-70% that the firm will not be able to continue as a going concern. However, in a survey of various types of decision-makers, the authors found that bankers and financial analysts perceived the term “substantial doubt” to indicate a higher likelihood of failure than did auditors, but judges and legislative staff perceived a lower likelihood of failure than did auditors.
financial statement users. Under the standard, management is required to disclose facts and circumstances that give rise to substantial doubt, as well as plans to redress the issues. However, current auditing standards permit auditors to communicate going concern uncertainties to financial statement issues only if, in the auditor’s judgment, management’s plans are insufficient to alleviate substantial doubt. Current auditing standards also limit the auditor’s ability to impart information about the process by which they analyze the company’s going concern status. Additionally, the auditing standards currently contain no provision for the auditor to explicitly communicate whether they agree or disagree with management’s assessment on operational outlooks and going concern (Burkholder 2017). Therefore, absent an explanatory paragraph added to the audit report – the uncommon "going concern opinion" – the auditor’s judgments related to and process for evaluating the existence of substantial doubt and consideration of management’s remedial plans are far from transparent to financial statement users.

In the same vein, Ernst & Young (EY) cautioned that, “given the differences between ASC 205-40 and the [auditing] standards, it is possible that the auditor may reach a different conclusion than management about the entity’s ability to continue as a going concern” (EY 2017). Consequently, while some have asserted that ASC 205-40 will allow financial statement users “to see both parts of the puzzle” (Rapoport 2017), financial statement users could encounter situations wherein management discloses a going concern issue, but the auditor issues a standard unqualified audit opinion. This combination results in a potential mixed signal that is difficult for financial statement users to interpret and could cause problems for auditors. Absent a

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2 For example, in its annual reports for both the year ended January 28, 2017 and the year ended January 28, 2018, Sears Holding Corp. provided disclosure under ASC 205-40 while its auditor, Deloitte, did not issue a going concern opinion. When contacted by the media regarding discussions on going concern issues between Sears and its auditors, a spokesman for Deloitte responded, “Professional standards prevent us from discussing client matters.” (Burkholder 2017).
going concern opinion, financial statement users have little insight into the auditor’s going concern-related judgments and evaluation process. This lack of insight would likely increase auditor liability in cases where an entity subsequently declares bankruptcy since details regarding the auditor’s going concern evaluation process and related judgments are particularly relevant for determining whether the auditor acted with due care or was professionally negligent.

Practitioners have begun to consider the potential implications of ASC 205-40 for auditors. In early 2017, Audit Analytics reported that they were currently “analyzing the effects of the new financial accounting regime” (Burkholder 2017), but it is unclear when this investigation might be complete and whether it will be timely enough to be useful to regulators and auditors. However, by utilizing experimental methods, we can investigate these issues presently and provide insight into possible mechanisms through which the new standard is affecting auditors. As such, our primary contribution lies in identifying the (likely unintended) consequences of ASC 205-40 on auditor liability. Secondarily, we investigate a potential means for auditors to reduce any additional liability under ASC 205-40.

We conduct two juror decision-making experiments to examine these issues. The setting for both experiments is one in which the auditor issues a standard unqualified audit opinion and the entity subsequently declares bankruptcy. An investor in the entity, who suffered substantial losses when the entity declared bankruptcy, sues the auditor for professional negligence, asserting the auditor should have issued a going concern opinion but failed to do so. We ask proxy juror participants to consider the facts of the case, assess auditor blame for the investor’s losses, and indicate whether they would find the auditor negligent.

In our first experiment, we investigate the effects of the new FASB standard and management disclosure of going concern matters on jurors’ assessments of auditor blame for
indepentendent losses and on jurors’ auditor negligence verdicts. Our results reveal that when
management does not disclose a going concern issue, jurors view auditors as more blameworthy
and more negligent under ASC 205-40 compared to the previous reporting environment. Further,
in the ASC 205-40 environment, when management discloses the existence of substantial doubt
(compared to when management does not disclose such doubt), jurors find auditors even more
blameworthy, despite the fact that the auditor has acted the same in both situations. These
findings indicate that the adoption of ASC 205-40 has important consequences for auditor
liability, which are especially interesting given that management’s responsibility has increased
under the standard, while the auditor’s responsibility remains unchanged. 3

Upcoming changes to the audit report required under AS 3101, The Auditor’s Report on
an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion (PCAOB
2017), may provide an avenue through which auditors can reduce this increased liability
exposure. Specifically, we examine the effect of adding a going concern-related critical audit
matter (CAM) to the audit report. 4,5 Our second experiment is set in the ASC 205-40
environment and employs a scenario in which management has disclosed a going concern issue.
We find that including a going concern-related CAM in the audit report mitigates auditor liability
when the auditor has not issued a going concern opinion. Mediation analyses reveal that this

3 Currently, while the ASB has updated their standards to address the new financial accounting standard, the
PCAOB has simply stated that “the AU section 341 requirements for the auditor’s evaluation, and the auditor’s
reporting when substantial doubt exists, have not changed and continue to be in effect” (PCAOB 2014, 2-3).
4 The requirements related to CAMs set forth under AS 3101 are effective for audits of fiscal years ending on or
after June 30, 2019 for large accelerated filers and December 15, 2020 for other filers.
5 Interestingly, the financial reporting environment in the US is different from international standards in the area of
going concern. Under ISA 570 (Revised), auditors are required to report specifically on going concern matters
within the audit report itself, including providing specific descriptions of both the auditor and management’s duties
related to going concern, regardless of whether a material uncertainty exists (IAASB 2015). Consequently,
international auditing standards may provide more transparency related to the auditor’s process for evaluating going
concern, and auditor liability under this framework is likely different from that experienced by auditors operating
under US standards. However, comparisons between US and international auditing standards is outside the scope of
this study, and liability differences under these distinct frameworks is a question for future research.
CAM-induced reduction in auditor liability is fully explained by jurors’ perception that the auditor was appropriately diligent when conducting the going concern evaluation. These results provide evidence supporting our assertion that increases in auditor liability under ASC 205-40 result from a lack of transparency regarding the auditor’s going concern assessment process.

This study offers contributions to both practice and the academic literature. There currently is little existing research examining the effects of ASC 205-40 on auditors; however, this is an important issue given that the responsibility for assessing the going concern assumption has historically fallen upon external auditors. Due to the litigious culture of the United States, auditors must be constantly aware of developments that could affect their professional liability. We provide experimental evidence regarding the effects of the new FASB financial accounting standard, management’s going concern-related disclosures under this standard, and the mitigating effects of going concern-related CAMs on auditor liability. Accordingly, this study provides information that may help auditors to better understand the consequences of their going concern judgments and reporting decisions in the current environment. Further, regulators may find the results of this study useful as they continue to promulgate and refine financial accounting and auditing standards.

This research also answers calls by the Center for Audit Quality (CAQ) for research on critical policy issues, including the audit implications of new accounting standards and the new audit reporting model that incorporates CAMs (CAQ 2018). Recent changes in financial accounting standards (i.e., ASC 205-40) and audit reporting standards (i.e., AS 3101) are policy issues that have a significant impact on auditors. Our research demonstrates that ASC 205-40 can increase auditor liability in certain circumstances, and that auditors should consider including
their going concern assessment as a CAM, when appropriate, to mitigate the liability impact of the new FASB standard.

Finally, our research contributes to the growing body of research related to CAMs. Prior studies suggest that the inclusion of CAMs may improve auditor outcomes in negligence lawsuits under certain circumstances (e.g., Brasel, Doxey, Grenier, and Reffett 2016) and may have the opposite effect under other circumstances (e.g., Gimbar, Hansen, and Ozlanski 2016). Recent research also demonstrates that the removal of CAMs from audit reports may increase jurors’ assessments of auditor negligence (Vinson, Robertson, and Cockrell 2018). The results of our study demonstrate that CAMs can be useful for shedding light on the auditor’s consideration of uncertain outcomes (e.g., a client’s bankruptcy), which reduces auditor liability.

II. BACKGROUND AND DEVELOPMENT OF HYPOTHESES

Background

The going concern assumption underlies financial reporting under Generally Accepted Accounting Principles (GAAP) (FASB 2014). In order to provide assurance that an entity’s financial statements are presented fairly in accordance with GAAP, auditors are required to consider whether there is substantial doubt about the entity’s ability to continue as a going concern. To do so, auditors are instructed to consider conditions or events that suggest that the entity may be unable to continue operating, and, if these conditions or events raise substantial doubt regarding the going concern assumption, consider management’s plans to mitigate the problem. If management’s plans are insufficient to mitigate substantial doubt, the auditor should issue a “going concern opinion” by adding a paragraph to the audit report detailing the circumstances that give rise to the doubt (PCAOB 2016; AICPA 2018). In so doing, the auditor
has the opportunity to help financial statement users better understand the bankruptcy risk of the entity.

Auditors have historically struggled to correctly identify and report going concern issues. Lennox (1999) documents that the issuance of a going concern opinion is a poor indicator of an entity’s financial distress. Similarly, Francis (2011) points out the high Type 1 and Type 2 error rates related to auditor’s going concern opinions. Francis (2011) also reviews prior research examining relationships between auditor characteristics and incentives and the propensity to issue going concern opinions. Much of this research suggests that auditors’ biases affect their propensity to issue such opinions. At the same time, auditors believe that failure to issue a going concern opinion for an entity that subsequently ceases operations can adversely impact auditor liability (Kida 1980; Carson et al. 2013; PCAOB 2012). Thus, it is important to examine factors, such as the adoption of ASC 205-40, which might affect auditor liability when auditors fail to issue a going concern opinion when, after the fact, an individual may conclude a going concern opinion was warranted.

The FASB’s promulgation of ASC 205-40 marked a major change in the consideration of the going concern assumption. Prior to ASC 205-40, the management of an entity was not required to conduct a formal analysis of the going concern assumption. However, under the new standard, management is required to do just that. Further, if substantial doubt exists, management must disclose the events and circumstances that give rise to the doubt and describe their plans to mitigate the problem(s), if possible (FASB 2016). We contend that the combination of the

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6 The potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for future events or conditions, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. The auditor cannot reasonably be expected to predict such future conditions or events. Accordingly, the absence of any reference to substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in an auditor's report cannot be viewed as a guarantee of the entity's ability to continue as a going concern for a reasonable period of time. (Paragraph .08 of AU-C 570).
existing audit standards and ASC 205-40 create the potential for reporting outcomes that may ultimately serve to confuse financial statement users. For example, under ASC 205-40, if management has substantial doubt about the going concern assumption, management must provide a footnote disclosure regarding the issue, regardless of whether such doubt is mitigated by management’s plans. While preliminary research suggests that auditors have become more likely to issue a going concern opinion since the adoption of ASC 205-40 (Krishnan, Krishnan, and Lee 2018), the auditor will issue a going concern opinion only if the auditor judges management’s plans as insufficient to mitigate substantial doubt (see Figure 1 for a side-by-side comparison of management’s and auditor’s responsibilities under ASC 205-40).

Since the effective date of ASC 205-40, there have been several instances in which management has disclosed substantial doubt while the auditor remained silent in the audit opinion (AICPA 2017a). The most notable of these cases is that of Sears Holdings Corporation (Sears). In accordance with the new accounting standard, Sears disclosed substantial doubt in both its 2017 and 2018 financial statements while its auditor, Deloitte, issued a clean audit opinion. The business media and Sears’ stakeholders were understandably confused by this mixed signal (Ajmera and Layne 2017; McKenna 2017; Burkholder 2017; DiNapoli and Naidu 2017), and Sears has since filed for a Chapter 11 bankruptcy (Sears 2019).

While there is currently no action being filed against Deloitte on behalf of Sears’ shareholders, in general, failure of the auditor to issue a going concern opinion may serve as grounds for claims of auditor negligence. The requirements of ASC 205-40 present somewhat

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7 Krishnan, Krishnan, and Lee (2018)’s post-ASC 205-40 sample included 120 instances in which management disclosed issues related to going concern. Of the 120 instances, 57 (47.5%) coincided with the issuance of a standard unqualified audit opinion.
of a quandary for auditors, because while managers are now required to disclose any instances of substantial doubt, outside issuing a going concern opinion (generally considered an extreme outcome), auditors’ options for communicating their consideration of going concern issues are limited. As such, we contemplate how the varied signals that arise due to the reporting requirements of ASC 205-40 and the auditing standards might influence outcomes in cases claiming auditor negligence.

**Development of Hypotheses**

In this section, we draw upon literature examining auditor negligence and blame attribution to formulate hypotheses. Specifically, we contemplate potential litigation outcomes when an entity declares bankruptcy after the auditor has issued a standard unqualified audit opinion. We also consider the possible mitigating effect of including the auditor’s assessment of the going concern assumption as a critical audit matter (CAM) in the audit report.

**Auditor Negligence and Juror Decision-Making**

Auditors are concerned about third-party liability (Palmrose 1997; Grubbs and Ethridge 2007). Specific to the going concern context, auditors believe that ignoring a going concern issue could lead to a lawsuit (PCAOB 2012), and prior literature suggests that issuing going

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8 While Sears’ CFO was able to further explain the rationale behind their going concern disclosure in the company’s blog (Hollar 2017), Deloitte declined to comment on the matter when asked by the media (McKenna 2017). This speaks to the extent to which the auditor’s hands are tied with respect to their ability to discuss the audit itself and the processes used to determine the entity’s ability to continue as a going concern. Although the auditor does have the option to include an emphasis paragraph in the audit report to call attention to management’s going concern disclosures, as noted previously, current auditing standards contain no provision for the auditor to explicitly communicate whether they agree or disagree with management’s assessment (Burkholder 2017)

9 Although prior research indicates most litigation against auditors is settled out of court due to the uncertainty inherent to jury trials (Maksymov, Pickerd, Lowe, Peecher, and Reffett 2018), it has also been shown that attorneys are not good at predicting the outcomes of jury trials and end up conceding more than necessary in settlements due to their beliefs about how jurors would react (Pickerd and Piercey 2018). Consequently, there remains a need for additional research that seeks to better inform auditors and their attorneys about what liability auditors would face if the case went to a jury trial.
concern opinions to financially-distressed clients can deter lawsuits and reduce large settlements against auditors (Kaplan and Williams 2013).

Prior research documents that jurors attach more credence to auditing standards approved by federal regulators (e.g., PCAOB auditing standards) than to standards established by the profession, but also consider more than just compliance with auditing standards when such information is provided (Buckless and Peace 1993). Research also demonstrates that negative outcomes cause juries to judge the auditor more harshly in cases of auditor negligence (Kadous 2000). Additionally, research documents that jurors unintentionally penalize auditors with more negligence verdicts in fraud cases when the auditor investigated the matter than when they did no investigation at all (Reffett 2010). However, none of the existing research examines juror judgments in the going concern context.

Kadous (2000, 339) breaks down the juror’s task into three components: 1) assessing standards of care, 2) assessing audit quality, and 3) comparing the two. However, under ASC 205-40, jurors are also given information such that they can consider management’s standards of care and whether management analyzed the company’s ability to continue as a going concern. When trying to determine the effect of ASC 205-40 on auditor liability, we must consider the fact that financial statement users may be comparing auditors to management in terms of the amount of information each provides.

Because of required disclosures regarding substantial doubt and management’s plans, ASC 205-40 could result in situations wherein financial statement users know relatively more about what management is doing than about what the auditor is doing. Because investors (and jurors) now have more information about management, they could view silence on the part of the auditor as a signal of negligence in performing the audit. In short, jurors may understand the
auditor’s duties under applicable standards, but they have no insight into the auditor’s due
diligence in carrying out those duties. This could give rise to widening the expectation gap
(Lowe 1994). Regulators have indicated the expectation gap results from: 1) the difference
between the information the market wants (in our context, the auditor’s evaluation of going
concern issues) and what is actually disclosed (in our context, nothing), and 2) a departure
between the way the market believes audits are conducted and the reality of the situation
(Franzel 2016).

Furthermore, research on hindsight bias suggests that ASC 205-40 may increase auditor
liability. Hindsight bias is an individual’s belief that past events should have been easily
foreseen, and prior research finds that hindsight bias plays a role in jurors’ decisions in auditor
negligence suits (e.g., Buchman 1985; Anderson, Jennings, and Reckers 1993). In the context
of a business failure, jurors who are influenced by hindsight bias are more likely to believe that
the auditor should have foreseen the ultimate outcome, especially if management has included a
disclosure of substantial doubt, and should have warned shareholders and creditors that the client
company was in financial distress.

In order to prevail in a civil lawsuit claiming auditor negligence for failure to issue a
going concern opinion, a plaintiff would need to convince the jury by a preponderance of the
evidence that the plaintiff’s losses arose because the auditor failed to exhibit due professional
care when assessing and reporting on the going concern assumption. Thus, the level of blame for
plaintiffs’ losses attributed to the auditor is likely a central consideration for jurors deciding such

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10 Outcome effects are similar to hindsight bias (Lipe 1993; Brazel, Jackson, Schaefer, and Stewart 2016). However, according to Brazel et al. (2016), outcome effects are “the direct impact of outcome knowledge on evaluations”, while hindsight bias is “the effect of outcome knowledge on the judged probability of outcomes (and, indirectly, evaluations)”. In our study, we argue that the primary mechanism is hindsight bias rather than outcome effects due to the fact that the jurors are assessing how likely the bankruptcy was to occur and whether the various parties should have foreseen it.
a case, and management disclosure under ASC 205-40 will likely influence jurors’ perceptions of blameworthiness.

**Blame Attribution**

Blame is a central consideration when determining professional liability (Brandon and Mueller 2006), and post-bankruptcy litigation is a complex setting in which there are several parties to whom jurors could ascribe blame for losses incurred. In the going concern context, we propose that, when deciding negligence verdicts in the context of an auditor’s Type 2 going concern reporting error, jurors allocate blame for investor losses among three parties: the auditor, management, and the investor.

Hindsight bias and the widening of the expectation gap could act to increase both assessments of auditor blame and negligence verdicts under ASC 205-40. In fact, the press coverage of the Sears and Deloitte situation is evidence that the expectation gap has increased with regards to auditor’s responsibility regarding going concern. In the ASC 205-40 environment, auditors are responsible not only for conducting an independent going concern assessment, but are also responsible for ensuring compliance with GAAP, which now includes considering management’s going concern assessment and related disclosures. Recall that ASC 205-40 dictates that management disclosures regarding going concern issues are required whenever substantial doubt exists, regardless of whether such doubt is mitigated by management’s plans. Hence, the absence of going concern-related disclosures in the financial statements suggests that substantial doubt existed for neither management nor the auditor. In

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11 The psychology literature contains many studies that address blame attribution. We tested both the Culpable Control Model (Alicke 2000) and Decision Affect Theory (Mellers, Schwartz, and Ritov 1999), which have proven informative in previous audit litigation studies; however, neither of these theories explain our results.

12 While we believe that this is the most likely inference to be drawn in this scenario, we acknowledge that financial statement users could also arrive at alternate conclusions. In the ASC 205-40 environment, if the auditor has substantial doubt, it is likely that the auditor would conclude that going-concern related disclosures are necessary, because disclosures are now required regardless of whether substantial doubt is mitigated. An appropriately
addition, when an entity declares bankruptcy after the auditor issued a standard unqualified opinion, jurors exhibiting hindsight bias would be likely to perceive the bankruptcy as an event the auditor should have foreseen and warned investors about. If this is the case, jurors are likely to ascribe more blame to the auditor and judge the auditor as more negligent.

In the pre-ASC 205-40 environment, hindsight bias will likely lead jurors to believe that failing to issue a going concern opinion when an entity subsequently declared bankruptcy was an error on the part of the auditor. However, in the ASC 205-40 reporting environment, when management does not disclose going concern issues in the financial statements, hindsight bias may lead jurors to believe that this scenario represents two errors on the part of the auditor – one for failing to issue a going concern opinion, and one for failing to require management disclosure of going concern issues. Thus, we predict the following:

**H1a:** When management of an entity has not disclosed going concern issues, jurors’ assessments of auditor blame for bankruptcy-related investor losses are greater under ASC 205-40 compared to the previous regulatory environment.

**H1b:** When management of an entity has not disclosed going concern issues, jurors are more likely to find auditors negligent (for failing to issue a going concern opinion) under ASC 205-40 compared to the previous regulatory environment.

H1a and H1b contemplate a scenario in which management has not disclosed going concern issues. We employ this scenario for important reasons. While management had the option to voluntarily disclose going concern issues prior to the adoption of ASC 205-40, managers have substantial disincentives to disclose going concern issues (or receive a going skeptical auditor who has concluded substantial doubt would likely challenge management’s assertion that substantial doubt does not exist. In this scenario, management has significant incentives to provide going concern-related disclosures, because failure to provide such disclosures is a GAAP departure sufficient to preclude the appropriately skeptical auditor from issuing an unqualified opinion. Hence, in the absence of going-concern related disclosures, we believe it is reasonable to infer that substantial doubt existed for neither the auditor nor management. Alternative explanations include that the auditor did not exercise appropriate skepticism in performing the audit, or that the auditor colluded with management to conceal substantial doubt. However, all of these explanations would likely lead jurors to increase both the blame ascribed to the auditor and negligence verdicts and are therefore consistent with our stated hypotheses.
concern opinion from the auditor) (Carson et al. 2013) and are unlikely to have done so.\footnote{Bochkay, Chychyla, Sankaraguruswamy, and Willenborg (2018) report that in their pre-ASC 205-40 IPO setting, only 6.8% of sample firms had voluntarily disclosed an issue with going concern in the same year the auditor gave the firm a clean audit opinion. Additionally, they find that management going concern disclosures contain information that is used by investors. An earlier study conducted by Mayew, Sethuraman, and Venkatachalam (2015) finds similar results for firms that have filed for bankruptcy.} Thus, before the promulgation of ASC 205-40, financial statement users were most likely to encounter situations in which management did not disclose going concern issues and the auditor issued a standard unqualified opinion. Hence, investigating this scenario allows for the cleanest test of the effect of ASC 205-40 (as compared to the previous regulatory environment) on auditor liability. We consider the effect of management disclosure of going concern issues with H2a and H2b.

Under ASC 205-40 (versus the pre-ASC 205-40 environment), management’s responsibility for warning investors of any going concern issues has increased. Prior literature indicates that disclosures affect investors’ perceptions of management attributes such as competence and trustworthiness (Mercer 2004). It follows that when management provides disclosure to investors about substantial doubt under ASC 205-40, such disclosure would reduce blame attributed to management because investors perceive management as more competent and/or trustworthy. If jurors attribute less blame to management when management discloses going concern issues, the blame may shift to either the auditor (who failed to issue a going concern opinion) or the investor (who failed to heed management’s warning). When the auditor does not issue a going concern opinion, we expect that at least some of that blame will shift to the auditor as hindsight bias is likely to take a role in jurors’ assessments. Thus, we hypothesize the following:

**H2a:** Under ASC 205-40, jurors’ assessments of auditor blame for bankruptcy-related investor losses are greater when management has disclosed going concern issues than when management has not.
**H2b**: Under ASC 205-40, jurors are more likely to find auditor negligent (for failing to issue a going concern opinion) when management has disclosed going concern issues than when management has not.

**Critical Audit Matters**

As we expect increases in auditor liability under ASC 205-40 are driven by hindsight bias and the expectation gap, we next consider a means by which these effects may be mitigated: critical audit matter paragraphs (CAMs).\(^{14}\) AS 3101 requires CAMs for public company audit reports beginning with fiscal years ending in June of 2019. The standard defines CAMs as any matter arising from the audit that was communicated or required to be communicated to the audit committee and that (1) relates to accounts or disclosures that are material to the financial statements and (2) involved especially challenging, subjective, or complex auditor judgment (PCAOB 2017). Some research suggests that under certain circumstances, CAMs may increase auditor negligence verdicts (e.g., Backof, Bowlin, and Goodson 2018). Other studies suggest that CAMs may decrease auditor negligence verdicts (e.g., Kachelmeier, Rimkus, Schmidt, and Valentine 2018; Gimbar et al. 2016). Brasel et al. (2016) find that when the auditor discloses a CAM related to a misstatement, jurors see the misstatement as more foreseeable to the investor and are less likely to find the auditor negligent.

The going concern assessment likely meets the criteria of a CAM, as this process involves significant auditor judgment related to uncertain future events, relates to disclosures likely to be considered material, and is presumably communicated to the audit committee. As

\(^{14}\) Although AS 3101 provides the auditor the option of including an emphasis paragraph in the audit report to call attention to management’s disclosures regarding substantial doubt, emphasis paragraphs would likely only serve to heighten scrutiny of management’s going concern analysis and would not provide information about the auditor’s assessment of such matters. Consequently, we believe that CAMs are likely a more effective method than emphasis paragraphs for mitigating increases in auditor liability under ASC 205-40; however, comparisons of the effects of these different mechanisms is beyond the scope of this project and is a question best explored by future research.
noted previously, we believe that increased auditor liability under the new FASB standard is driven by a lack of transparency regarding the auditor’s going concern assessment process and judgments. If the auditor is silent with regards to going concern matters, financial statement users (and jurors) do not have information they may consider relevant for evaluating performance of the auditor, which may work to widen the expectation gap. Similarly, when the auditor is silent, jurors may be more likely succumb to hindsight bias and conclude that the subsequent business failure should have been foreseeable to the auditor and find the auditor negligent for failing to warn financial statement users. In contrast, including a CAM in the audit report may alleviate these effects, as the CAM highlights the judgmental nature and inherent uncertainty involved in the going concern evaluation. This indicates that the auditor at least considered the possibility of an unfavorable outcome and also provides financial statement users information relevant for assessing the auditor’s performance. Consequently, we predict that the expected increase in auditor liability under ASC 205-40 and when management discloses going concern issues will be mitigated by including the auditor’s evaluation of the going concern assumption as a CAM in the audit report. Formally:

**H3a:** Jurors’ assessments of auditor blame for bankruptcy-related investor losses are lower when auditors include a going concern-related CAM in the audit report than when auditors do not.

**H3b:** Jurors are less likely to find auditors negligent (for failing to issue a going concern opinion) when auditors include a going concern-related CAM than when auditors do not.

Further, because we expect that a lack of transparency about the auditor’s going concern evaluation gives rise to increased auditor liability under ASC 205-40, we predict that perceptions of auditors’ diligence explains the effects predicted in H3a and H3b. Specifically:

**H4:** Jurors’ perceptions of auditors’ diligence in performing the going concern evaluation mediate the relation between inclusion of a going concern-related CAM and auditor blame and negligence verdicts.
III. EXPERIMENTAL METHOD

Experiment 1 Method

We test our predictions about the effects of ASC 205-40 and management disclosure of going concern issues on jurors’ assessments of auditor blame for investor losses (H1a and H2a) and juror’s verdicts regarding auditor negligence for failing to issue a going concern opinion (H1b and H2b) using two similar experiments, which we label Experiment 1a and Experiment 1b. While we designed both Experiments 1a and 1b to test these hypotheses, the experiments differ in two meaningful ways. First, as explained below, we measured the dependent variables slightly differently in the two experiments. We also collect an additional key process measure in Experiment 1b – participants’ perceptions of auditor diligence in performing the going concern evaluation, which we utilize as a mediating variable to explain the effects of disclosure on negligence and blame under ASC 205-40.15

Participants – Experiment 1a

Experiment 1a is a 30-minute experiment administered to 158 online participants recruited via Prolific.16 We eliminated six participants who reported work experience as an auditor or a lawyer. The remaining 152 participants were 44 percent male with a mean age of 31.69.17

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15 We received IRB approval prior to collecting data for Experiments 1a, 1b, and 2.
16 Prolific.ac is an online subject recruitment platform, similar to Amazon’s Mechanical Turk, but is focused on research studies (Palan and Schitter 2018). Prolific has been shown to be suitable for social science experiments (Peer, Brandimarte, Samat, and Acquisti 2017) and has been used in other accounting studies (Rennekamp, Rupar, and Seybert 2018).
17 Because auditors and lawyers likely possess specialized knowledge that would cause them to be excluded from a jury in our setting, we exclude such participants in all experiments reported herein to be consistent with the likely procedural outcomes of jury selection in auditor negligence cases. However, all reported findings are robust to the inclusion of these participants.
Participants – Experiment 1b

Experiment 1b is also a 30-minute experiment administered to a non-overlapping sample of 191 online participants recruited via Prolific. We eliminated 5 participants who reported work experience as an auditor or lawyer, leaving 186 participants. Participants were 41 percent male with a mean age of 31.96.

Experimental Design – Experiment 1a and Experiment 1b

Both Experiment 1a and Experiment 1b have a 2 × 2 between-participants design.\(^{18}\) We manipulated whether management was required to comply with ASC 205-40 (i.e., ASC 205-40 Absent versus Present) and whether management disclosed going concern issues in the financial statements (No Disclosure versus Disclosure). Participants were asked to take the role of jurors in an auditor negligence case.\(^{19}\) A large investor in the auditee company sued the auditor after the company went bankrupt. The investor claimed that the auditor was negligent for failing to issue a going concern opinion.

In all cases, the client, a fitness company, went bankrupt after reducing research and development activities and subsequently missing the launch of a new wearable fitness device. Participants were given both the auditor’s and investor’s arguments as well as information about the applicable auditing and financial accounting standards. In each condition, participants also saw “plain language” summaries of the applicable standards and the actions taken by the auditor and management.

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\(^{18}\) In both Experiments 1a and 1b, participants were randomly assigned to one of four experimental conditions and received $4.00 for their participation in the study.

\(^{19}\) The auditor negligence case used in this study was patterned after that used in Kadous and Mercer (2016). However, due to critical differences in our setting (namely the standards themselves being different and the absence of financial statement misstatements arising from fraud), the case used in our study is original and was subjected to extensive piloting to ensure that the wording was precise and the content was understandable to potential participants.
Dependent Variables – Experiment 1a

Once participants finished reading the case materials and answered all comprehension check questions correctly, we asked them to allocate blame for the investor’s losses between the auditor, management, and the investor. This measure of relative blame was elicited by asking participants to indicate what percentage of blame (out of 100 percent) they would allocate to each of the three parties. Participants then indicated whether they believe the auditor was negligent. We capture participants’ negligence verdicts as an indicator variable equal to one for negligent and zero for not negligent.

Dependent Variables – Experiment 1b

In Experiment 1b, we collected negligence verdicts before any blame measures so as to not lead participants into thinking that negligence is only a product of blame. Participants were then asked to indicate how deserving of blame were each of the three parties – the auditor, management, and the investor. Also differing from Experiment 1a, we measured absolute blame for each party using 101-point sliding scales anchored at “0 – Not Deserving” and “100 – Very Deserving.” This measure allows the total amount of blame assigned to the parties to vary by participant, by summing the deservingness of blame of the three parties. By configuring the question in this way, we are able to assess both absolute blame and relative blame, where relative blame is the proportion of the total blame participants assign to each party.

20 In order for our manipulations to be successful, participants had to understand the combined implications of financial accounting and auditing standards. In order to ensure understanding of this complex material, we required participants to answer comprehension check questions correctly before proceeding to the dependent variables. Participants who failed to answer comprehension check questions correctly were informed that they missed one or more questions and required to review the case materials and revise their answers before moving on. Importantly, participants were not informed which (or how many) answers were incorrect. Our results are inferentially identical when controlling for whether participants passed comprehension checks on the first attempt or not.
Experiment 2 Method

Participants – Experiment 2

To test our hypotheses related to critical audit matters (CAMs) (H3a, H3b, and H4), we administered a 30-minute experiment to a non-overlapping sample of 98 online participants recruited via Prolific. We eliminated two participants who reported experience as an auditor or lawyer. The 96 remaining participants were 47 percent male with a mean age of 32.20.

Experimental Design – Experiment 2

Experiment 2 has a 1 × 2 between-participants design.21 As a control, we compare these two conditions with the ASC 205-40 Present with Disclosure condition from Experiment 1b, as this condition represents the scenario financial statement users are most likely to encounter (and in which they are most likely to blame the auditor) in the current environment. All details of the case presented to participants in Experiment 2 were identical to this condition from Experiment 1b with the exception of the addition of information about CAMs. We manipulated whether the auditor included a going concern-related CAM in the auditor’s report (No CAM versus Yes CAM) and provided participants with information about auditors’ obligations under AS 3101, including the definition of CAMs. In each condition, we provided participants with “plain language” summaries of the applicable financial reporting and auditing standards.

Dependent Variables – Experiment 2

Once participants finished reading the case materials and answered all comprehension check questions correctly, they evaluated whether the auditor was negligent. Consistent with Experiment 1, negligence was measured using a binary indicator. Participants then indicated how much blame they would assign to the auditor, management, and the investor. Consistent with

21 In Experiment 2, participants were randomly assigned to one of two experimental conditions and received $4.00 for their participation in the study.
Experiment 1b, blame was measured on a 101-point scale for each party. Also consistent with Experiment 1b, we asked participants to indicate the extent to which the auditor was appropriately diligent in performing the going concern evaluation (GC Diligence).

IV. RESULTS

Data Used to Test Hypotheses 1 and 2

To test the predicted effects of ASC 205-40 (Absent vs. Present) and management disclosure of going concern issues (No Disclosure versus Disclosure) on our dependent variables, we combine the data from Experiments 1a and 1b. However, before presenting results, we first discuss how we resolve the differences in these experiments.

Because we elicited negligence verdicts both after (Experiment 1a) and before (Experiment 1b) eliciting participants’ assessments of blame, we test to see if any statistical differences exist in negligence verdicts between Experiments 1a and 1b. We find no differences (untabulated $t = 0.631$, p-value = 0.529, two-tailed) and continue to find no differences when we allow the dummy variable Experiment to interact with our independent variables (untabulated, all p-values > 0.22). In addition, Experiments 1a and 1b elicit measures of blame in subtly different ways. Experiment 1a measured relative blame by having participants assign blame to the auditor, management, and the investor, fixing total blame at 100. Experiment 1b allowed total blame to vary by asking participants to assess absolute blame for each of the three parties on a separate scale for each party. Experiment 1b allows us to quantify the effect of our independent variables on total blame. By doing so, we are able to both impute absolute blame for Experiment 1a participants and calculate relative blame for Experiment 1b participants. This dual-natured dependent variable, coupled with additional power associated with a larger set of participants (total n = 338), constitute our basis for combining Experiments 1a and 1b. Our results are
consistent using either experiment in isolation. We include the dummy variable Experiment in our analyses to control for any unforeseen differences between Experiments 1a and 1b.

**Test of Hypotheses 1 and 2**

In Figure 2, we graphically present both of our variables for auditor blame — *relative* blame attributed to the auditor and *absolute* blame attributed to the auditor. As we note that the pattern of results appears consistent regardless of the measure used, we perform all of our reported statistical tests using the *relative* auditor blame measure.\(^{22}\) In Panel A of Table 1, we present means and standard deviations of *relative* auditor blame by condition, demonstrating that management disclosure substantially increases auditor blame. When management does not disclose going concern issues, participants attribute 33.56 percent of total blame for investor losses to the auditors. When management does disclose, participants attribute 48.94 percent of total blame to the auditors. This is consistent with our expectation that management disclosure of going concern issues alters financial statement users’ perceptions of the auditor’s decision to issue a standard unqualified audit opinion. That is, jurors feel that auditors were less diligent in carrying out their duties related to the going concern evaluation when management has disclosed going concern issues.

[INSERT FIGURE 2 AND TABLE 1 ABOUT HERE]

To test the effect of ASC 205-40 (*Absent* versus *Present*) on auditor blame and negligence verdicts (H1a and H1b), we focus on the *No Disclosure* conditions because that is the most likely scenario to have existed prior to ASC 205-40 (i.e., managers were unlikely to voluntarily disclose going concern matters). While we present the overall ANCOVA of the effect of ASC 205-40 and management disclosure on relative auditor blame in Panel B of Table 1, we

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\(^{22}\) All statistical tests are robust to using the absolute measure of audit blame. Further, in supplemental analyses, we examine the effect of our independent variables on total blame of all parties.
draw attention to the simple effects tests. We find support for H1a (p = 0.048, one-tailed) that the
presence of ASC 205-40 increases auditor blame (compared to the previous reporting
environment where ASC 205-40 was absent) when management does not disclose going concern
issues. In Panel A of Table 2, we present the proportion of participants who found the auditor
negligent by condition. We note that the pattern of results follows that of auditor blame, and we
find that, when management does not disclose going concern issues, auditors are found negligent
more often under ASC 205-40 (68.2 percent of the time) than under the previous reporting
environment (50.6 percent of the time) (χ² = 5.987, p-value = 0.007, one-tailed), providing
support for H1b. In Panel B, we present a categorical data model to more precisely test H1b, as
our independent variable (ASC 205-40 Present) is categorical and our dependent variable
dichotomous. We find significantly higher proportion of auditor negligence under ASC 205-40
than without this standard being present (p-value = 0.008, one-tailed), also supporting H1b.23

Under ASC 205-40, we hypothesize greater auditor blame (H2a) and negligence verdicts
(H2b) when management discloses going concern issues in the financial statements than when
managers do not disclose (holding constant the issuance of a standard unqualified audit opinion).
As seen in Panel A of Table 1, when ASC 205-40 is Present, jurors assign more relative blame to
auditors when management discloses (48.28 percent) compared to when management does not
disclose (36.71 percent). As seen in Panel B of Table 1, the simple effect is significant (p =
0.001, one-tailed), supporting H2a. In Panel 1 of Table 2, we fail to find via simple chi-square
tests a statistically significant difference in negligence decisions (H2b) due to management
disclosure in the presence of ASC 205-40 (χ² = 1.487, p-value = 0.111, one-tailed), though the

23 Using logistic regression, we find inferentially identical results.
differences fall in the predicted direction and approach conventional levels of significance. Using our categorical data model in Panel B of Table 2, we also fail to find statistical support for H2b.

[INSERT TABLE 2 ABOUT HERE]

**Test of Hypotheses 3 and 4**

To test our hypotheses that including a going concern-related CAM in the audit report can reduce blame attributed to auditors (H3a) and negligence verdicts (H3b), we utilize data from Experiment 2. In Panel A of Table 3, we present means (standard deviations) of auditor blame and negligence verdicts by condition. We utilize the ASC 205-40 Present with Disclosure condition from Experiment 1b as the control condition, as this represents the situation financial statement users are most likely to encounter in practice (i.e., management disclosure with a standard unqualified opinion). To ensure that the additional information about critical audit matters in and of itself cannot explain the predicted differences, we compare the Yes CAM condition to both the Control and No CAM conditions. We find that relative auditor blame and assessments of negligence are significantly lower when auditors include a going-concern related CAM than when they do not, supporting H3a and H3b. All univariate comparisons are reported in Panel B of Table 3. Further, we find that perceptions of auditor diligence with respect to going concern (i.e., GC Diligence) are significantly higher when including a going concern-related CAM (compared to both the Control and No CAM conditions).

Next, we follow Baron and Kenny’s (1986) method to test our hypothesis that perceptions of auditor diligence (GC Diligence) in performing the going concern evaluation mediate the effect of going concern-related CAMs on assessments of auditor blame (H4). First, we find a significant relation between our conditions in Experiment 2 (Control, No CAM, and Yes CAM) and relative auditor blame (untabulated; \( t = -3.315 \), p-value < 0.001, one-tailed).
Next, we document a significant relation between our conditions and *GC Diligence* (untabulated; $t = 3.867$, p-value < 0.001, one-tailed). We also find a significant relation between *GC Diligence* and relative auditor blame (untabulated; $t = -9.774$, p-value < 0.001, one-tailed). Finally, we show full mediation by documenting an insignificant relation between our conditions and relative auditor blame when including *GC Diligence* as a control variable (untabulated; $t = -1.163$, p-value = 0.247, two-tailed). Thus, holding constant the issuance of a standard unqualified audit opinion, inclusion of a going concern-related CAM in the audit report reduces auditor blame through increased perceptions of diligence, supporting H4. Further, for auditor negligence – a dichotomous variable necessitating a modification to standard mediation tests (MacKinnon and Dwyer 1993) – we also find evidence of mediation with 67% of the effect mediated by *GC Diligence* and a significant Sobel test (untabulated; Z-score = −3.31, p < 0.001, one-tailed).

**Supplemental Analyses**

In supplemental analyses, we aim to accomplish two goals. First, we provide analyses to support the theoretical underpinnings for our hypotheses. Second, we document the effect of ASC 205-40 and management disclosure on other dependent variables of peripheral interest – total blame assigned, management blame, and investor blame.

**Analyses Supporting Theory**

In developing our hypotheses, we argue that ASC 205-40 increases auditors’ responsibilities such that they not only must exercise professional judgment in evaluating the

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24 We also test our mediation hypothesis (H4) using the simple mediation model described in Hayes (2018). Consistent with the reported Baron and Kenny (1986) analysis, we find an indirect effect of our CAM manipulations on auditor blame through perceptions of auditor diligence regarding going concern and an insignificant direct effect of our CAM manipulations on auditor blame (p-value = 0.247). Additionally, using a transformed version of our binary negligence variable (confidence in negligence decision times negligence verdict where negligent equals 1 and not negligent equals −1), we find results consistent with our analysis of auditor blame.
going concern assumption, but also must provide assurance managers are complying with the financial statement disclosure requirements under this standard (i.e., that the financial statements are prepared in accordance with GAAP). If jurors believe that auditors are failing to meet these general requirements, perceptions of auditor quality would decrease under ASC 205-40. We asked post-experimental questions to capture participants’ perceptions related to positive auditor characteristics of independence, competence, and absence of collusion with management.\textsuperscript{25} Using factor analysis, these three characteristics combine to one factor, which we label as \textit{General Auditor Quality}.\textsuperscript{26} We test for mediation of H1a using this factor. We document a significant increasing effect on relative auditor blame of ASC 205-40 when management does not disclose (untabulated; \( t = 1.816, \) p-value = 0.035, one-tailed). We find a marginally significant negative relation between ASC 205-40 and \textit{General Auditor Quality} (untabulated; \( t = -1.413, \) p-value = 0.080, one-tailed). We also find a significant relation between \textit{General Auditor Quality} and relative auditor blame (untabulated; \( t = -9.166, \) p-value < 0.001, one-tailed). We show full mediation by documenting an insignificant relation between ASC 205-40 and relative auditor blame when including \textit{General Auditor Quality} as a control variable (untabulated; \( t = 1.216, \) p-value = 0.226, two-tailed). This provides evidence that increased blame attributed to auditors under ASC 205-40 is primarily driven by reduced perceptions of auditors effectively fulfilling their duties (i.e., poor auditor quality).\textsuperscript{27}

In developing predictions about relative auditor blame under ASC 205-40, we highlight that scenarios in which management discloses going concern issues but the auditor issues a

\textsuperscript{25} We elicited participants’ beliefs regarding the likelihood of collusion, we then reverse coded this variable for the factor analysis.

\textsuperscript{26} The eigenvalue for this factor is 2.085 and it explains 70\% of the variance.

\textsuperscript{27} We find partial mediation (22\% of the effect mediated) when examining \textit{Negligence} as the dependent variable (z-score = 1.38, p = 0.08, one-tailed).
standard unqualified audit opinion provides a mixed signal to financial statement users. In such circumstances, financial statement users may question whether auditors have carried out their duties specifically related to going concern. As such, we examine the role that GC Diligence has in explaining the effect of management disclosure on relative auditor blame under ASC 205-40.\textsuperscript{28} Consistent with results related to H2a, we find that management disclosure under ASC 205-40 has a significant positive effect on relative auditor blame of (untabulated; $t = 1.613$, p-value = 0.055, one-tailed). We also find a significant negative relation between management disclosure and GC Diligence (untabulated; $t = -1.728$, p-value = 0.044, one-tailed). We also document a significant effect of GC Diligence on relative auditor blame (untabulated; $t = -7.372$, p-value < 0.001, one-tailed). Lastly, we show full mediation by documenting an insignificant relation between management disclosure and relative auditor blame when including GC Diligence as a control variable (untabulated; $t = 0.695$, p-value = 0.489, two-tailed). In other words, jurors heightened attribution of blame to auditors when management discloses going concern (and auditors do not issue a going concern opinion) is driven by reduced perceptions diligence in performing the going concern evaluation.

\textit{Additional Dependent Variables}

In Experiment 1b, we allow the amount to total blame assigned to vary by asking participants to assess the deservingness of blame for each of the three parties involved – the auditor, management, and the investor – each on a 101-point scale. As such, our independent variables could have a direct effect on total blame as measured in Experiment 1b. In Table 4, we present the means (standard deviations) of total blame by condition (Panel A) and the overall ANOVA (Panel B) for total blame. We note a marginally significant increasing effect of ASC

\textsuperscript{28} Note that, since we only collected the variable GC Diligence in Experiment 1b, the analysis described utilizes only these participants.
28 on total blame (p-value = 0.067, two-tailed) and a strongly positive effect of management disclosure (p-value = 0.006, two-tailed). From this, we can conclude that jurors see some of these scenarios as more “blameworthy” than others, confirming our expectation that jurors’ perceptions of the setting employed vary under each condition. Recall that our measures of relative blame control for shifts in total blame between conditions and that our results are robust to using absolute blame.29

[INSERT TABLE 4 ABOUT HERE]

In Table 5 (Table 6), we present means (standard deviations) and ANCOVA results for relative management (investor) blame. Figures 3 and 4 graphically depict the means for relative management and investor blame, respectively. We find that the presence of ASC 205-40 significantly increases relative management blame (Panel B of Table 5, $F = 2.904, p < 0.001$) while reducing relative investor blame (Panel B of Table 6, $F = 7.917, p = 0.003$). Management disclosure significantly decreases relative management blame (Panel B of Table 5, $F = 74.471, p < 0.001$) and increases relative investor blame (Panel B of Table 6, $F = 5.475, p = 0.010$). These findings are inferentially identical using our measures of absolute management and investor blame. The most interesting of these results is that, even with all of the potential additional information available to investors under ASC 205-40, jurors hold them less blameworthy than before ASC 205-40. At first glance, this finding seems counterintuitive; that is, we would normally expect investors to be perceived as more blameworthy in an environment in which they had relatively more information upon which to base investment decisions. However, this result

29 Additionally, we note that, while the presence of ASC 205-40 and management disclosure both have a significant positive effect on total blame assigned to the three parties in Experiment 1b (as documented in Table 4), we find no significant difference in total blame between the Control condition and the No CAM (untabulated $t = 1.077, p = 0.284$, two-tailed) and Yes CAM conditions (untabulated $t = 0.047, p = 0.963$, two-tailed), nor between the two CAM conditions (untabulated $t = 1.078, p = 0.284$, two-tailed) in Experiment 2.
speaks to the additional perceived responsibility of management and auditors in the ASC 205-40 environment.

V. DISCUSSION AND CONCLUSION

The litigious environment under which auditors operate creates a continuing need to examine and better understand the impact of new and upcoming financial accounting and audit reporting standards on auditors’ legal liability. In this study, we use juror decision-making experiments to investigate the impact of the FASB’s new going concern financial accounting standard, ASC 205-40, on juror’s assessments of auditor blame for investor losses and auditor negligence verdicts. We set our experiments in a context where the auditor has been sued for professional negligence after failing to issue a going concern opinion for an auditee that subsequently declared bankruptcy. We conclude that when management does not disclose going concern issues in the financial statements, jurors are more likely to blame auditors for investor losses and find auditors negligent under ASC 205-40 than under the previous reporting environment. We also find that, under ASC 205-40, auditors suffer even more blame attribution and negligence verdicts when management discloses going concern issues compared to when management does not. Finally, we find that auditors can mitigate the increases in liability exposure driven by ASC 205-40 and management disclosure under the standard by including a CAM in the audit report related to the auditor’s process for assessing the going concern assumption. This occurs because when auditors include a going concern-related CAM in the audit report, jurors feel that the auditors were more diligent with respect to the going concern evaluation. These results have important implications for audit practitioners, regulators, and
academics wishing to better understand the impact of new and forthcoming changes in the financial reporting environment.
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FIGURE 1: Management’s Analysis under ASC 205-40 (Auditor’s Responsibility – Unchanged by ASC 205-40)

Is there substantial doubt about the entity’s ability to continue as a going concern?

No → M: No disclosures required
A: (Issue clean audit opinion)

Yes → Is it probable that management’s plan will be implemented effectively?

No → M: Provide disclosures and a statement indicating that there is substantial doubt about the entity’s ability to continue as a going concern.
A: (Add an explanatory paragraph to the audit report.)

Yes → Is it probable that management’s plan will mitigate the relevant conditions or events causing the substantial doubt?

No → M: Provide disclosures indicating that substantial doubt existed, but was mitigated by management’s plan.
A: (Issue clean opinion - explanatory paragraph not necessary.)

Yes → M: No disclosures required
A: (Issue clean audit opinion)
FIGURE 2: Auditor Blame

Relative Blame Attributed to Auditor

The above figures show how auditor blame differs due to the absence/presence of ASC 205-40 and whether or not management discloses going concern issues. Relative auditor blame is the amount of blame (out of 100) that is attributed to auditors (compared to management and investors). Absolute auditor blame is the extent to which auditors are deserving of blame, independent of management’s and investor’s deservingness of blame.
FIGURE 3: Management Blame

Relative Blame Attributed to Management

The above figures show how management blame differs due to the absence/presence of ASC 205-40 and whether or not management discloses going concern issues. Relative management blame is the amount of blame (out of 100) that is attributed to management (compared to auditors and investors). Absolute auditor blame is the extent to which management is deserving of blame, independent of auditor’s and investor’s deservingness of blame.

Absolute Blame Attributed to Management

The above figures show how management blame differs due to the absence/presence of ASC 205-40 and whether or not management discloses going concern issues. Relative management blame is the amount of blame (out of 100) that is attributed to management (compared to auditors and investors). Absolute auditor blame is the extent to which management is deserving of blame, independent of auditor’s and investor’s deservingness of blame.
The above figures show how investor blame differs due to the absence/presence of ASC 205-40 and whether or not management discloses going concern issues. Relative investor blame is the amount of blame (out of 100) that is attributed to investors (compared to auditors and management). Absolute investor blame is the extent to which investors are deserving of blame, independent of auditor’s and management’s deservingness of blame.
### TABLE 1: Experiment 1 Results for Relative Auditor Blame

#### Panel A: Mean (Standard Deviation) of Relative Auditor Blame by Condition

<table>
<thead>
<tr>
<th>Management Disclosure&lt;sup&gt;b&lt;/sup&gt;</th>
<th>ASC 205-40&lt;sup&gt;c&lt;/sup&gt;</th>
<th>Row Means</th>
</tr>
</thead>
<tbody>
<tr>
<td>No Disclosure</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Absent</td>
<td>30.45% (25.87)</td>
<td>33.56% (22.56)</td>
</tr>
<tr>
<td>Present</td>
<td>36.71% (18.29)</td>
<td></td>
</tr>
<tr>
<td>n = 85</td>
<td>n = 84</td>
<td>n = 169</td>
</tr>
<tr>
<td>Disclosure</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Absent</td>
<td>49.59% (29.54)</td>
<td>48.94% (26.27)</td>
</tr>
<tr>
<td>Present</td>
<td>48.28% (22.66)</td>
<td></td>
</tr>
<tr>
<td>n = 85</td>
<td>n = 84</td>
<td>n = 169</td>
</tr>
<tr>
<td>Column Means</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>40.02% (29.28)</td>
<td>42.50% (21.33)</td>
</tr>
<tr>
<td></td>
<td>n = 170</td>
<td>n = 168</td>
</tr>
</tbody>
</table>

#### Panel B: Analysis of Covariance---Tests of H1a and H2a

<table>
<thead>
<tr>
<th>Factor</th>
<th>df</th>
<th>MS</th>
<th>F</th>
<th>p-value&lt;sup&gt;a&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>Omnibus ANCOVA:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Experiment&lt;sup&gt;d&lt;/sup&gt;</td>
<td>1</td>
<td>176.531</td>
<td>0.294</td>
<td>0.588</td>
</tr>
<tr>
<td>ASC 205-40 (Absent versus Present)</td>
<td>1</td>
<td>499.674</td>
<td>0.833</td>
<td>0.362</td>
</tr>
<tr>
<td>Management Disclosure (No versus Yes)</td>
<td>1</td>
<td>19989.055</td>
<td>33.342</td>
<td>&lt;0.001</td>
</tr>
<tr>
<td>ASC 205-40 × Management Disclosure</td>
<td>1</td>
<td>1206.678</td>
<td>2.012</td>
<td>0.157</td>
</tr>
<tr>
<td>Error</td>
<td>333</td>
<td>599.515</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Simple effects:

- Simple effect of ASC 205-40 under No Management Disclosure
  - 1 | 1665.096 | 2.777 | 0.048

- Simple effect of Management Disclosure under ASC 205-40 Present
  - 1 | 5665.298 | 9.450 | 0.001

<sup>a</sup> In cases where we have directional predictions, p-values are reported as one-tailed and denoted in **bold** font.

<sup>b</sup> Relative auditor blame is the amount of blame (0 to 100) attributed to auditors with the remaining amount attributed to management and/or investors. For Experiment 1a, this measure was directly elicited. For Experiment 1b, this measure was imputed based on participants’ responses to auditor’s deservingness of blame relative to management’s and investor’s deservingness of blame.

<sup>c</sup> In the Disclosure condition, management disclosed the company’s financial problems in the notes to the financial statements. In the No Disclosure condition, management did not disclose this information.

<sup>d</sup> In the ASC 205-40 Absent condition, management was not required to disclose the company’s financial problems (though they could voluntarily disclose). In the ASC 205-40 Present condition, management was required to disclose the company’s financial problems.

<sup>e</sup> We include the dummy variable Experiment in these analyses to control for any unforeseen differences between Experiment 1a and Experiment 1b.
### Panel A: Percentage (Standard Deviation) of Jurors Finding the Auditor Negligent\(^a\) by Condition

<table>
<thead>
<tr>
<th>Management Disclosure(^b)</th>
<th>ASC 205-40(^c)</th>
<th>(\chi^2)</th>
<th>p-value(^*)</th>
</tr>
</thead>
<tbody>
<tr>
<td>No Disclosure</td>
<td>50.6% (0.50)</td>
<td>68.2% (0.47)</td>
<td>5.987</td>
</tr>
<tr>
<td>Disclosure</td>
<td>69.0% (0.47)</td>
<td>77.4% (0.42)</td>
<td>1.784</td>
</tr>
<tr>
<td>(\chi^2)</td>
<td>5.489</td>
<td>1.487</td>
<td></td>
</tr>
</tbody>
</table>

| p-value                   | 0.009            | 0.111    |              |

### Panel B: Categorical Data Model—Tests of H1b and H2b

<table>
<thead>
<tr>
<th>Factor</th>
<th>Estimate</th>
<th>(\chi^2)</th>
<th>p-value(^*)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall Model:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Experiment(^d)</td>
<td>0.079</td>
<td>0.44</td>
<td>0.506</td>
</tr>
<tr>
<td>ASC 205-40 (Absent versus Present)</td>
<td>0.314</td>
<td>6.98</td>
<td><strong>0.004</strong></td>
</tr>
<tr>
<td>Management Disclosure (No versus Yes)</td>
<td>0.291</td>
<td>6.00</td>
<td><strong>0.007</strong></td>
</tr>
<tr>
<td>ASC 205-40 (\times) Management Disclosure</td>
<td>0.079</td>
<td>0.44</td>
<td>0.508</td>
</tr>
<tr>
<td>Simple effects:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Simple effect of ASC 205-40 under No Management Disclosure</td>
<td>0.388</td>
<td>5.85</td>
<td><strong>0.008</strong></td>
</tr>
<tr>
<td>Simple effect of Management Disclosure under ASC 205-40 Present</td>
<td>0.214</td>
<td>1.48</td>
<td><strong>0.112</strong></td>
</tr>
</tbody>
</table>

\(^*\) In cases where we have directional predictions, p-values are reported as one-tailed and denoted in **bold** font.

\(^a\) Auditor negligence is measured dichotomously as 1 if the auditor is deemed negligent for not including an explanatory paragraph on going concern and 0 if not deemed negligent. This variable is collected after (before) assessing blame in Experiment 1a (Experiment 1b).

\(^b\) In the Disclosure condition, management disclosed the company’s financial problems in the notes to the financial statements. In the No Disclosure condition, management did not disclose this information.

\(^c\) In the ASC 205-40 Absent condition, management was not required to disclose the company’s financial problems (though they could voluntarily disclose). In the ASC 205-40 Present condition, management was required to disclose the company’s financial problems.

\(^d\) We include the dummy variable Experiment in these analyses to control for any unforeseen differences between Experiment 1a and Experiment 1b.
## TABLE 3: Experiment 2 Results

### Panel A: Mean (Standard Deviation) By Condition

<table>
<thead>
<tr>
<th>Condition</th>
<th>Relative Auditor Blame</th>
<th>Absolute Auditor Blame</th>
<th>Auditor Negligence</th>
<th>Going Concern Diligence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Control</td>
<td>44.91% (20.91)</td>
<td>67.065 (29.023)</td>
<td>78.72% (41.70)</td>
<td>2.370 (1.451)</td>
</tr>
<tr>
<td></td>
<td>n = 46</td>
<td>n = 46</td>
<td>n = 46</td>
<td>n = 46</td>
</tr>
<tr>
<td>No CAM on GC</td>
<td>43.81% (36.08)</td>
<td>60.082 (30.396)</td>
<td>63.27% (48.71)</td>
<td>2.980 (1.652)</td>
</tr>
<tr>
<td></td>
<td>n = 49</td>
<td>n = 49</td>
<td>n = 49</td>
<td>n = 49</td>
</tr>
<tr>
<td>Yes CAM on GC</td>
<td>29.08% (23.38)</td>
<td>45.149 (35.773)</td>
<td>46.81% (50.44)</td>
<td>3.617 (1.568)</td>
</tr>
<tr>
<td></td>
<td>n = 47</td>
<td>n = 47</td>
<td>n = 47</td>
<td>n = 47</td>
</tr>
</tbody>
</table>

### Panel B: Univariate Comparisons

<table>
<thead>
<tr>
<th>Relative Auditor Blame</th>
<th>Absolute Auditor Blame</th>
<th>Auditor Negligence</th>
<th>Going Concern Diligence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Control versus No CAM on GC</td>
<td>0.234 (0.815)</td>
<td>3.436 (1.144)</td>
<td>3.026 (0.256)</td>
</tr>
<tr>
<td>Control versus Yes CAM on GC</td>
<td>(&lt;0.001)</td>
<td>(0.001)</td>
<td>(0.002)</td>
</tr>
<tr>
<td>No CAM on GC versus Yes CAM on GC</td>
<td>(0.111)</td>
<td>(0.001)</td>
<td>(0.054)</td>
</tr>
</tbody>
</table>

* In cases where we have directional predictions, p-values are reported as one-tailed and denoted in **bold** font.

a The Control condition is the 46 participants from the condition in Experiment 1b that predicts the highest auditor blame and negligence verdicts (ASC 205-40 Present with Disclosure). The Yes CAM on GC (No CAM on GC) condition discusses CAMs and states that auditors did (not) include assessment of GC as a CAM in the audit report.

b Relative auditor blame is the amount of blame (0 to 100) attributed to auditors with the remaining amount attributed to management and/or investors. This measure was imputed based on participants’ responses to auditor’s deservingness of blame relative to management’s and investor’s deservingness of blame.

c Absolute auditor blame is measured as the extent of agreement that auditors are deserving of blame (on a 101-point Likert scale).

d Auditor negligence is measured dichotomously as 1 if the auditor is deemed negligent for not including an explanatory paragraph on going concern and 0 if not deemed negligent.

e GC Diligence measures the extent to which participants rated the auditor as appropriately diligent in performing the going concern evaluation (on a 6-point Likert scale).
TABLE 4: Analyses of Total Blame by Condition (Experiment 1b)

Panel A: Mean (Standard Deviation) of Total Blame\(^a\) By Condition

<table>
<thead>
<tr>
<th>Management Disclosure(^b)</th>
<th>ASC 205-40(^c)</th>
<th>Row Means</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Absent</td>
<td>Present</td>
</tr>
<tr>
<td>No Disclosure</td>
<td>156.26</td>
<td>167.80</td>
</tr>
<tr>
<td></td>
<td>(53.05)</td>
<td>(40.17)</td>
</tr>
<tr>
<td>n = 47</td>
<td></td>
<td>n = 44</td>
</tr>
<tr>
<td>Disclosure</td>
<td>138.98</td>
<td>150.28</td>
</tr>
<tr>
<td></td>
<td>(38.65)</td>
<td>(34.45)</td>
</tr>
<tr>
<td>n = 49</td>
<td></td>
<td>n = 46</td>
</tr>
<tr>
<td>Column Means</td>
<td>147.44</td>
<td>158.84</td>
</tr>
<tr>
<td></td>
<td>(46.83)</td>
<td>(38.18)</td>
</tr>
<tr>
<td>n = 96</td>
<td></td>
<td>n = 90</td>
</tr>
</tbody>
</table>

Panel B: Analysis of Variance

<table>
<thead>
<tr>
<th>Factor</th>
<th>df</th>
<th>MS</th>
<th>F</th>
<th>(p)-value*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Omnibus ANOVA:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ASC 205-40 (Absent versus Present)</td>
<td>1</td>
<td>6056.907</td>
<td>3.403</td>
<td>0.067</td>
</tr>
<tr>
<td>Management Disclosure (No versus Yes)</td>
<td>1</td>
<td>14047.922</td>
<td>7.893</td>
<td>0.006</td>
</tr>
<tr>
<td>ASC 205-40 × Management Disclosure</td>
<td>1</td>
<td>0.653</td>
<td>&lt;0.001</td>
<td>0.985</td>
</tr>
<tr>
<td>Error</td>
<td>182</td>
<td>1779.903</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* \(p\)-values are two-tailed.

\(^a\) Total blame is the sum of the deservingness of blame measure for each of the three parties – auditors, management, and investors.

\(^b\) In the Disclosure condition, management disclosed the company’s financial problems in the notes to the financial statements. In the No Disclosure condition, management did not disclose this information.

\(^c\) In the ASC 205-40 Absent condition, management was not required to disclose the company’s financial problems (though they could voluntarily disclose). In the ASC 205-40 Present condition, management was required to disclose the company’s financial problems.
TABLE 5: Analyses of Relative Management Blame By Condition (Experiment 1)

Panel A: Mean (Standard Deviation) of Relative Management Blame<sup>a</sup> By Condition

<table>
<thead>
<tr>
<th>Management Disclosure&lt;sup&gt;b&lt;/sup&gt;</th>
<th>ASC 205-40&lt;sup&gt;c&lt;/sup&gt;</th>
<th>Row Means</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Absent</td>
<td>Present</td>
</tr>
<tr>
<td><strong>No Disclosure</strong></td>
<td>50.36% (27.24)</td>
<td>52.10% (18.73)</td>
</tr>
<tr>
<td>n = 85</td>
<td>n = 84</td>
<td>n = 169</td>
</tr>
<tr>
<td><strong>Disclosure</strong></td>
<td>27.24% (22.41)</td>
<td>33.63% (21.10)</td>
</tr>
<tr>
<td>n = 85</td>
<td>n = 84</td>
<td>n = 169</td>
</tr>
<tr>
<td><strong>Column Means</strong></td>
<td>38.80% (26.72)</td>
<td>42.87% (21.94)</td>
</tr>
<tr>
<td>n = 170</td>
<td>n = 168</td>
<td></td>
</tr>
</tbody>
</table>

Panel B: Analysis of Covariance

<table>
<thead>
<tr>
<th>Factor</th>
<th>df</th>
<th>MS</th>
<th>F</th>
<th>p-value&lt;sup&gt;a&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>Omnibus ANCOVA:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Experiment&lt;sup&gt;d&lt;/sup&gt;</td>
<td>1</td>
<td>206.641</td>
<td>0.420</td>
<td>0.517</td>
</tr>
<tr>
<td>ASC 205-40 (Absent versus Present)</td>
<td>1</td>
<td>1428.682</td>
<td>2.904</td>
<td>0.089</td>
</tr>
<tr>
<td>Management Disclosure (No versus Yes)</td>
<td>1</td>
<td>36634.902</td>
<td>74.471</td>
<td>&lt;0.001</td>
</tr>
<tr>
<td>ASC 205-40 x Management Disclosure</td>
<td>1</td>
<td>456.538</td>
<td>0.928</td>
<td>0.336</td>
</tr>
<tr>
<td>Error</td>
<td>333</td>
<td>491.938</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<sup>a</sup> P-values are two-tailed.

<sup>b</sup> Relative management blame is the amount of blame (0 to 100) attributed to management with the remaining amount attributed to auditors and/or investors. For Experiment 1a, this measure was directly elicited. For Experiment 1b, this measure was imputed based on participants’ responses to management’s deservingness of blame relative to auditor’s and investor’s deservingness of blame.

<sup>c</sup> In the Disclosure condition, management disclosed the company’s financial problems in the notes to the financial statements. In the No Disclosure condition, management did not disclose this information.

<sup>d</sup> In the ASC 205-40 Absent condition, management was not required to disclose the company’s financial problems (though they could voluntarily disclose). In the ASC 205-40 Present condition, management was required to disclose the company’s financial problems.

<sup>d</sup> We include the dummy variable Experiment in these analyses to control for any unforeseen differences between Experiment 1a and Experiment 1b.
TABLE 6: Analyses of Relative Investor Blame By Condition (Experiment 1)

Panel A: Mean (Standard Deviation) of Relative Investor Blame By Condition

<table>
<thead>
<tr>
<th>Management Disclosure</th>
<th>ASC 205-40c</th>
<th>Row Means</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Absent</td>
<td>Present</td>
</tr>
<tr>
<td>No Disclosure</td>
<td>19.19% (23.95)</td>
<td>11.19% (15.25)</td>
</tr>
<tr>
<td></td>
<td>n = 85</td>
<td>n = 84</td>
</tr>
<tr>
<td>Disclosure</td>
<td>23.17% (24.19)</td>
<td>18.08% (20.70)</td>
</tr>
<tr>
<td></td>
<td>n = 85</td>
<td>n = 84</td>
</tr>
<tr>
<td>Column Means</td>
<td>21.18% (24.08)</td>
<td>14.64% (18.45)</td>
</tr>
<tr>
<td></td>
<td>n = 170</td>
<td>n = 168</td>
</tr>
</tbody>
</table>

Panel B: Analysis of Covariance

<table>
<thead>
<tr>
<th>Factor</th>
<th>df</th>
<th>MS</th>
<th>F</th>
<th>p-value*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Omnibus ANCOVA:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Experimentd</td>
<td>1</td>
<td>1.185</td>
<td>0.003</td>
<td>0.959</td>
</tr>
<tr>
<td>ASC 205-40 (Absent versus Present)</td>
<td>1</td>
<td>3618.177</td>
<td>7.917</td>
<td>0.005</td>
</tr>
<tr>
<td>Management Disclosure (No versus Yes)</td>
<td>1</td>
<td>2501.981</td>
<td>5.475</td>
<td>0.020</td>
</tr>
<tr>
<td>ASC 205-40 × Management Disclosure</td>
<td>1</td>
<td>178.655</td>
<td>0.391</td>
<td>0.532</td>
</tr>
<tr>
<td>Error</td>
<td>333</td>
<td>457.018</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* P-values are two-tailed.

a Relative investor blame is the amount of blame (0 to 100) attributed to investors with the remaining amount attributed to auditors and/or management. For Experiment 1a, this measure was directly elicited. For Experiment 1b, this measure was imputed based on participants’ responses to investor’s deservingness of blame relative to auditor’s and management’s deservingness of blame.
b In the Disclosure condition, management disclosed the company’s financial problems in the notes to the financial statements. In the No Disclosure condition, management did not disclose this information.
c In the ASC 205-40 Absent condition, management was not required to disclose the company’s financial problems (though they could voluntarily disclose). In the ASC 205-40 Present condition, management was required to disclose the company’s financial problems.
d We include the dummy variable Experiment in these analyses to control for any unforeseen differences between Experiment 1a and Experiment 1b.