

Research Article

Going Concern Disclosure for Local Governments

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Going concern opinions (GCOs) indicate that auditors have significant doubt about an entity's ability to continue operation one year after the financial statement date. This study addresses the following research questions: What are the factors that motivate auditors to issue GCOs to governmental entities? Does a governmental entity disclose going concern uncertainty in the footnotes or the MD&A section of annual financial reports (AFRs) either the year before or the year when the entity receives a GCO? To what extent does the entity disclose the GCO factors used by auditors? We find that auditors most often cited two reasons, "Deficiency in Funds" and "Losses or Revenue Declines," accounting for the majority of reasons given for a going concern opinion. Further, the disclosure is most likely to be in the notes to the AFRs. In addition, we find that going concern reporting varies by auditor type (state auditors vs. public accounting firms), government size, and government type. We also find some evidence that going concern disclosures improve after the enactment of GASB No. 56. The results of our study should be of interest to stakeholders' interested in lead indicators of fiscal distress.

Keywords: Governmental Accounting, Going Concern Opinions, Going Concern Disclosure

Going concern opinions (GCOs) indicate that auditors have significant doubt about an entity's ability to continue operation one year after the financial statement date. GCOs, if issued timely and with reasonable accuracy, can be valuable information to stakeholders. In 2009, the Governmental Accounting Standard Board (GASB) released Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*. GASB Statement No. 56 clarified management's responsibilities involving going concern reporting for governmental units.

This study investigates the factors that influence auditors to issue a going concern opinion to state and local governments. In addition, we also examine when and to what extent the GCO-receiving governmental entities disclose going concern uncertainty in either footnotes or management discussion and analysis section (MD&A) of their annual financial reports (AFRs). Identifying the reasons a GCO is given in the government setting can help GASB and stakeholders evaluate the content of going concern disclosure requirements. In addition, examination of the disclosure of GCOs helps inform the GASB and stakeholders whether GASB Statement No. 56 works effectively for governments.

This study addresses the following research questions: (1) What are the factors that motivate auditors to issue GCOs to governmental entities? (2) Does a governmental entity disclose going concern uncertainty in footnotes or the MD&A section of AFRs either the year before or the year when the entity receives a GCO? And, (3) to what extent does the entity disclose the GCO factors used by auditors?

To address our research questions, stage 1 of our research project involved deriving a sample of municipalities that have received a going concern opinion since 1996, codifying the reasons for the audit firm giving the going concern opinion, and the characteristics of the municipality receiving the going concern opinion. We identified a sample of 318 cities and counties that have received a going concern opinion from the Federal Audit Clearinghouse database of A-133

audits. We collected AFRs for each of these governments from their websites or state depositories, with the assistance of the GASB staff. Stage 2 of our research utilized the AFRs collected in stage 1 and examined the determinants of GCOs given by auditors and whether governmental entities disclose these influencing factors of GCOs either in the year before or in the year when the entity receives a GCO.

We find that auditors have used seven major categories (aggregating 32 distinct reasons) of justifications that have motivated auditors to issue a going concern opinion to a governmental entity: Deficiency in Funds, Losses or Revenue Declines, State Oversight, Going Concern Given to Part of the Organization, Debt Issues, Legal, and Cash Shortage. The two most often cited reasons, “Deficiency in Funds” and “Losses or Revenue Declines,” account for the majority of reasons for giving a going concern opinion. The top two reasons remain the top two if we split our sample by total governmental fund revenues (a size proxy), or if we separately compare cities and counties. However, when we split the sample by whether the government is audited by the state, we find that “State Oversight” is the leading reason given for a going concern opinion for governments audited by the state. Furthermore, our results show that going concern disclosure improved after the enactment of GASB No. 56.

In regards to whether and to what extent a GCO-receiving governmental entity discloses going concern uncertainty in the footnotes or the MD&A section of its AFRs in the year prior to or when the entity receives a GCO, we find that most governments disclose in their notes or MD&A the reasons for receiving a going concern opinion in the year they receive the GCO, and the majority disclose the reasons in the prior year AFR as well. The notes to the financial statements is the most likely place to find the cited reasons, and around half of the current year note disclosures include a standalone note titled “Going Concern.”

The remainder of the paper is organized as follows: The next section provides background. The third section discusses the data collection process. Section four presents the detailed analysis of the research results; in section five, we summarize the findings and limitations of the study.

Background

Auditor’s Going Concern Evaluation for State and Local Governments (SLGs)

The external financial statement auditor for SLGs has the responsibility to evaluate the government’s ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the financial statement date. The American Institute of Certified Public Accountants (AICPA) provides guidance for auditors regarding going concern evaluation of SLGs:

“The auditor’s evaluation is based on the auditor’s knowledge of relevant conditions or events that exist at, or have occurred prior to, the date of the auditor’s report. Information about such conditions or events is obtained from the application of auditing procedures planned and performed to achieve audit objectives that are related to management’s assertions embodied in the financial statements being audited, including assertions required by GASB Statement No. 56. AU-C section 570 provides guidance to the auditor on (a) the adequacy of financial statement disclosure, (b) the need to modify the auditor’s report, and (c) audit documentation concerning the auditor’s going concern evaluation. Additionally, AU-C section 570 states that, ordinarily, information that significantly contradicts the going concern assumption relates to the entity’s inability to

continue to meet its obligations as they become due without substantial disposition of assets outside the ordinary course of business, restructuring of debt, externally forced revisions of its operations, or similar actions” (AICPA, 2015, p. 509).

Per AU-C section 570, when auditors determine whether the government will continue as a going concern, auditors need to perform analytical procedures, review subsequent events, review the government’s compliance with the terms of debt and loans, review minutes of meetings of stockholders and boards and important committees, inquire the government’s legal counsel about litigation and claims, and confirm with related and third parties of detailed arrangements to provide/maintain financial support. AICPA (2015) supplements these aforementioned procedures with additional procedures that capture items that are either unique or significant to the government. For instance, auditors need to review correspondence from rating agencies for any adverse downgrade of the entity’s overall credit rating or that of any specific bond issue.

AICPA (2015) requires auditors to perform their assessment of going concern independent of management’s assessment. Unique to governments, the auditor also should consider whether *other* governments have a legal or moral authority to subsidize the government being audited. For example, a city or county might be perceived to have the responsibility to financially assist special districts within their geographic borders. These subsidies should be considered when the auditor is determining whether there is substantial doubt about the ability of a government to continue as a going concern.

Going Concern Disclosure Requirements for SLGs

GASB Statement No. 34 paragraph 11(h) requires a government to include a discussion in MD&A of currently known facts, decisions, and conditions that are expected to have a significant impact on the government’s financial position or results of operations.¹ Based on the GASB 34 requirements, a government should have a discussion of potential issues that are associated with going concern in MD&A, depending on the facts and circumstances that can raise substantial doubt about the government’s ability to continue to operate.

GASB Statement No. 56 places several requirements for note disclosures if a government determines there is substantial doubt about its ability to continue as a going concern for the 12 month period subsequent to the financial statement date or shortly thereafter. As summarized by AICPA (2015), these note disclosure requirements include descriptions of pertinent conditions and events that lead to the going concern assessment, possible effects of aforementioned conditions and events, government officials’ evaluation of the significance of those conditions and events, and mitigating factors, potential discontinuance of operations, and government officials’ plans including related financial information, etc.

Going Concern Evaluations by SLGs

GASB Statement No. 56 requires SLGs to evaluate whether there is substantial doubt about their ability to continue as a going concern for 12 months beyond the financial statement date. If a

¹ In this study, we collected data before and after the implementation of GASB No. 34. In our tabulated analysis, we include a variable for whether the government adopted GASB 34. Adoption may be due to either the fiscal year being before the implementation period or the government electing to not adopt all provisions of GASB 34. See Khumawala, Marlowe, and Neely (2014) for a discussion on why governments elect not to comply with Generally Accepted Accounting Principles (GAAP).

government currently has information that may raise substantial doubt shortly after this 12 month period (e.g. within three months after fiscal year end), the government should consider the information and disclose it appropriately. GASB No. 56 provides several examples of such information that may significantly contradict the going concern assumption (AICPA, 2015). For instance, a government is unable to continue to meet its obligations without substantial disposition of its assets or has restructuring of debt. Another example is the government's "submission to the oversight of a separate fiscal assistance authority or financial review board."

More precisely, GASB Statement No. 56 provides the following indicators that may raise significant doubt about a government's ability to continue as a going concern:

- "Negative trends. Recurring periods in which expenses and expenditures significantly exceed revenues, recurring unsubsidized operating losses in business-type activities consistent working capital deficiencies, continuing negative operating cash flows from business-type activities, or adverse key financial ratios.
- Other indications of possible financial difficulties. Default on bonds, loans or similar agreements, proximity to debt and tax limitations, denial of usual trade credit from suppliers, restructuring of debt (other than refundings), noncompliance with statutory capital or reserve requirements, or the need to seek new sources or methods of financing or to dispose of substantial assets.
- Internal matters. Work stoppages or other labor difficulties, substantial dependence on the success of a particular project or program, uneconomic long-term commitments (burdensome labor contracts for example) or the need to significantly revise operations.
- External matters. Legal proceedings, legislation, or similar matters that might jeopardize intergovernmental revenues and the fiscal sustainability of key governmental programs; loss of a critical license or patent for a business-type activity; loss of a principal customer, taxpayer, or supplier; or uninsured or underinsured catastrophe such as a drought, earthquake, or flood" (AICPA, 2015, p. 507).

GASB No. 56 also gives several additional events or conditions that may indicate substantial doubt about a government's ability to continue to operate (AICPA, 2015) such as continuous significant deficits in fund balance or net position, extremely high estimated liability for uninsured risks (e.g., large adverse legal settlements), high anticipated costs on construction or similar long-term projects that the government can reasonably finance, large pension, or other postemployment benefit obligations combined with declining revenues (including diminishing tax revenue due to recession), unwillingness of government officials to pay legally incurred liabilities or to continue funding programs at current levels, significant investment losses, bond rating downgraded below investment grade, debt covenant violations, excessive short- and long-term borrowing to reduce cash shortage, eliminate deficits or meet operating needs, and increased borrowings from component units that are unlikely to be repaid within a reasonable time frame.

GCOs and Organizations' Financial Characteristics

Though governments operate differently from for-profit firms, auditors' going concern decisions in the for-profit world may share some commonality. For instance, the for-profit literature links the likelihood of a GCO with a firm's financial distress. One important distress indicator is a firm's ability to repay its debt. Chen and Church (1992) documented that the debt default status is useful in identifying firms that have received a GCO. Mutchler (1985), Levitan and Knoblett (1985), and Menon and Schwartz (1987) revealed that factors such as short-term liquidity, profitability, and organizations' ability to generate sufficient cash flow from operations influence

Table 1. Sample Selection

	N
City and county observations identified by FAC database as having a going concern opinion	318
Less: government year observations unable to obtain a AFR	185
Less: government year observations with no going concern language in audit report	35
Total sample of going concern opinions	98
Total sample of going concern opinions for cities	80
Total sample of going concern opinions for counties	18
Total unique governments with going concern opinions	45

GCO issuance decisions.

Several studies investigated the financial distress of government units. For example, Trussel and Patrick (2013) developed a model that predicts whether a government will reduce public services, while Trussel and Patrick (2012) developed a model that predicts fiscal distress in local municipalities. Kloha, Weissert, and Kleine (2005) developed a 10 point scale that predicts local fiscal distress for a sample of Michigan municipalities. Singla, Comeaux, and Kirschner (2014) attempted to utilize fiscal distress models to differentiate local governments that file for Chapter 9 bankruptcy compared with fiscally distressed governments that do not file for bankruptcy. They find that while the models classify bankrupt governments as distressed, the level of distress is not appreciably greater for bankrupt governments compared with non-bankrupt governments.

GCOs and Nonprofit Organizations

Government and nonprofit charitable organizations (NPOs) are not profit-driven entities and the financial reporting of these two types of entities shares some similarities. There are a couple of going concern studies focusing on not-for-profit organizations. Feng (2017) reported that the likelihood that a nonprofit charitable organization (NPO) receives a GCO decreases with its liquidity, size, and its receipt of a low-risk status in a Single Audit, but increases if the NPO underreports its fundraising expenses or has continuous losses, internal control deficiencies or material noncompliance with laws and regulations. Feng (2014) also documented adverse economic consequence of GCOs in NPOs such as declining government grants and contributions after an NPO receives a GCO. Petrovits, Shakespeare, and Shih (2011) reported that having a GCO increases the likelihood that an NPO has internal control deficiencies during the post-GCO period. In turn, weak internal control allows fraud to be perpetrated, prevents an NPO from operating efficiently, and thereby weakens the NPO's viability (Greenlee, Fischer, Gordon, & Keating, 2007; Wells, 2005). Overall, while the prior literature suggested several facets to the decision to give a going concern opinion, indicators of fiscal distress play a primary role. The next section details our data collection.

Data Collection

Table 1 presents the sample selection process. We obtained the financial and auditing data from the Federal Audit Clearinghouse (FAC) Database. Because this study is funded with the Gil Crain Memorial Research Grant by GASB, GASB has collected the majority of the Annual

Table 2. Frequency Number of Times Represented in the Sample

Number of Going Concern Opinions	Frequency
10	1
7	1
6	1
5	2
4	2
3	5
2	9
1	24
Total	45

Table 3. Frequency by Year

Fiscal Year	Frequency
1996	1
1997	1
1998	1
1999	2
2000	1
2001	3
2002	3
2003	5
2004	7
2005	6
2006	6
2007	6
2008	11
2009	11
2010	16
2011	16
2012	1
2013	1
Total	98

Table 4. Frequency by Audit Firm Type

Audit Firm Type	Frequency	Percent of Total
Big 4	9	9%
State Auditor	22	23%
All other Audit Firms	67	68%
Total	98	100%

Financial Reports (AFRs) for this research.² We first identified 318 government-year observations that have going concern opinions.³ We then deleted 185 government-year observations due to lack of AFRs.⁴ After reading audit reports in AFRs, we remove 35

² We are grateful for GASB's support, especially the support from GASB Research Manager Dean Mead and his colleagues.

Table 5. Descriptive Statistics

Variable	N	Mean	Median
Cash	84	\$68,470,208	\$15,851,378
Total assets	81	\$966,528,105	\$156,359,953
Current LTD	80	\$116,578,003	\$4,681,439
Long term debt	80	\$355,433,556	\$57,250,088
Total liabilities	80	\$609,140,395	\$75,591,753
Net investment in capital assets	80	\$368,574,943	\$65,792,276
Restricted debt purposes	68	\$22,213,138	\$5,366,096
Restricted non-debt purposes	77	\$37,237,848	\$12,851,624
Total restricted funds	96	\$45,799,077	\$14,312,369
Total net position	84	\$352,813,294	\$53,155,851
Total expenses governmental activities	84	\$223,046,786	\$71,139,992
Total expenses	84	\$280,771,243	\$75,870,330
Program revenues charges for services	84	\$66,939,401	\$19,893,156
Net change in revenues and expenses	84	\$-162,918,162	\$-33,864,620
Total general revenues	84	\$145,160,903	\$31,134,991
Changes in net assets	84	\$-17,707,662	\$-1,380,277
Total unrestricted net assets	84	\$-51,764,949	\$-1,263,399
GFOA certificate	98	29.59%	0%
Governmental funds: Expenditures	98	\$227,356,985	\$60,629,024
Governmental funds: Revenues	98	\$204,304,943	\$57,401,013
Governmental funds: Liabilities	95	\$106,054,918	\$23,026,788
Governmental funds: Funds balance	98	\$65,111,916	\$14,994,484

government-year observations because auditors, in fact, did not issue a going concern opinion in these reports. This happened perhaps due to data errors when audit opinions were entered in the FAC database. As a result, we have 98 government-year observations with going concern opinions in our final sample. Out of these 98 government-year observations, 80 are for cities and 18 are for counties. There are 45 unique governments with going concern opinions in the sample.

Several governments are represented more than once in our sample (see table 2). Roughly half (24 out of 45) are represented once, nine of 45 are represented twice, and five out of 45 are represented three times. In the extreme, one government is represented ten times in the sample (received 10 going concern opinions over the study period). The earliest audit year we have in our sample is 1996, and the most recent year is 2013 (see table 3). The majority of our sample is in audit years 2008 to 2011 (54 of the 98). Nine percent of the sample is audited by the Big 4, 23% are audited by the state, and 68% by other audit firms (see table 4).

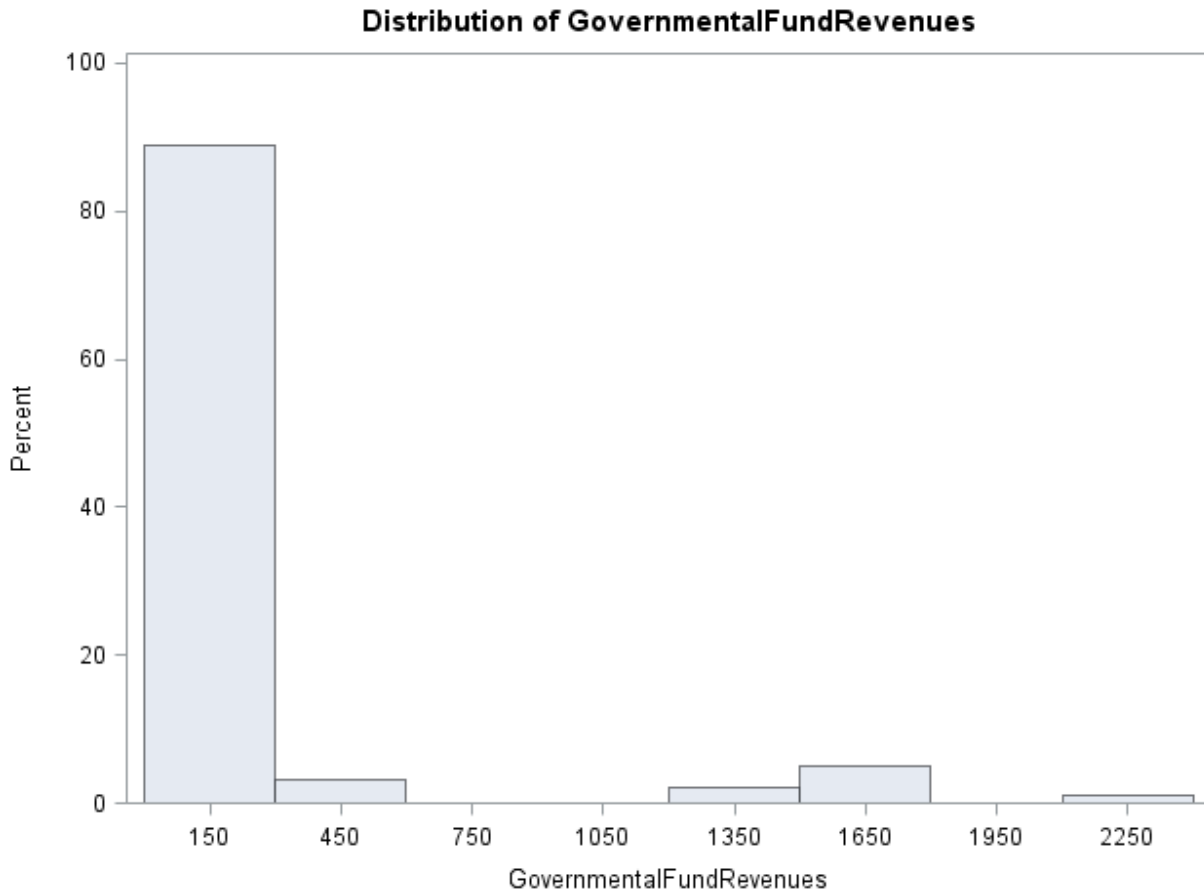
Results

Descriptive Statistics

³ The 318 government-year observations represent the total number of cities and counties with going concern opinions in the FAC database. After discussion with the GASB, it was agreed that the study should exclude all other government types (ex: school districts, special purpose entities, townships).

⁴ We asked our graduate assistants to help us conduct an extensive search for AFRs either on the entities' website or via Google search engine. Our graduate assistants also contacted these governments by phone asking for AFRs.

Figure 1. Size Histogram (in millions)



About 30% of the 98 AFRs sampled have the Government Finance Officers Association (GFOA) Certificate, which indicates a high quality of financial reporting. Descriptive statistics of the sample governments are presented in table 5. The sample governments have mean values of \$967 million in total assets, \$609 million in total liabilities, and \$353 million in total net position. The median total assets, total liabilities, and total net position of the sample governments are \$156 million, \$76 million, and \$53 million, respectively. More than half of the mean total liabilities are long-term debt (\$355 million) and the mean current portion of long-term debt amounts to \$117 million. This suggests that the sample governments rely heavily on long-term borrowing. Indeed, governments restrict roughly \$22 million (mean value) of net position for debt purposes. The median long-term debts of the sample are \$57 million.

The mean total expenses of the sample are \$280 million, including \$223 million total expenses from governmental activities. The median total expenses are \$75 million, with \$71 million from governmental activities. The mean and median program revenue charges for services are \$66 million and \$19 million, respectively. The mean and median total general revenues are \$145 million and \$31 million, respectively. The mean and median changes in net assets are \$-17 million and \$-1.38 million, suggesting that the sample governments have deficits. On average, total unrestricted net assets of the sample governments are \$-52 million (14% of the mean total net assets). The median total unrestricted net assets are \$-1.26 million (1% of the median total net assets), indicating that some sample governments have very large negative unrestricted net assets. This evidence suggests that the sample governments lack readily available financial resources and are under financial distress.

For the governmental funds, the mean (median) total expenditures are \$227 million (\$61 million), and the mean (median) total revenues are \$204 million (\$57 million). Turning to the governmental funds balance sheet, mean (median) total liabilities are \$106 million (\$23 million), and the total governmental fund balance mean (median) are \$65 million (\$15 million). Figure 1 provides a histogram of total governmental fund revenues. Roughly 90% of the sample is below \$500 million in total governmental fund revenues with the largest government reporting over \$2 billion in governmental fund revenues.

Auditors' Justifications for Issuing Going Concern Opinions

A GCO indicates that an entity is likely to discontinue its operation or is unable to meet its obligations as they become due within 12 months subsequent to the financial statement date or shortly thereafter. In this study, we investigated the factors that motivate auditors to issue going concern opinions to governmental entities.

Table 6 summarizes the justifications that auditors have used in their auditor reports when they issue going concern opinions in seven categories. The categories and the number of corresponding occurrences in the sample for each category (in parentheses), ranked from top to bottom, are as follows: deficiency in funds (44); losses or revenue declines (42); state oversight (29); going concern given to part of the organization (24); debt issues (13); legal (9); and, cash shortage (7). The categories are further explained in the appendix.

In accordance with GASB Statement 56, governments are required to make disclosures when there is substantial doubt about their ability to continue as a going concern. In the category of "deficiency in funds," out of 44 AFRs, about 68% disclose the issue in the MD&A and 95% disclose similar information in footnotes in the going concern year; 52% disclose the issue in the MD&A and 68% in the footnotes in the year prior to the going concern year. About 36% of 44 AFRs in the category have a footnote labeled "Going Concern Note." About 68% of these 44 AFRs adopted GASB 34.

For the 42 AFRs within the category of "losses or revenue declines," about 55% disclose the issue in the MD&A and 86% disclose similar information in the footnotes of the going concern year, and only 43% disclose the issue in MD&A and 52% in the footnotes in the year prior to the issuance of GCOs. About 48% of the 42 AFRs in the category have a footnote entitled "Going Concern." About 67% of these 42 AFRs adopted GASB 34.

Out of 29 cases in the category of "state oversight," about 59% disclose the issue in the MD&A and 100% disclose similar information in the footnotes of the going concern year and 34% in the MD&A and 100% in the footnotes of the year prior to the going concern year. About 17% of the 29 AFRs in the category have a footnote entitled "Going Concern." About 76% of these 29 AFRs adopted GASB 34.

In the category of "going concern given to part of the organization," out of the 24 AFRs, about 42% disclose the issue in the MD&A and 75% disclose similar information in the footnotes of the going concern year, and 33% in the MD&A and 75% in the footnotes of the year prior to the going concern year. About 54% of 24 AFRs in the category have a footnote entitled "Going Concern." About 79% of these 24 AFRs adopted GASB 34.

For 13 cases in the category of "debt issues," about 31% of AFRs disclose the issue in the MD&A and 85% disclose similar information in the footnotes of the going concern year, and 23% in the

Table 6. Reasons for Going Concern

Going Concern Reason	N	MD&A	PY_MD&A	Notes	PY_Notes	PY_AFR	Had PY_MD&A	GASB 34	Going Concern
Deficiency in Funds	44	68.18%	52.27%	95.45%	68.18%	84.09%	54.55%	68.18%	36.36%
Losses or Revenue Declines	42	54.76%	42.86%	85.71%	52.38%	80.95%	54.76%	66.67%	47.62%
State Oversight	29	58.62%	34.48%	100.00%	65.52%	93.10%	68.97%	75.86%	17.24%
Going Concern Given to Part of the Organization	24	41.67%	33.33%	75.00%	75.00%	83.33%	66.67%	79.17%	54.17%
Debt Issues	13	30.77%	23.08%	84.62%	69.23%	69.23%	46.15%	53.85%	61.54%
Legal	9	100.0%	66.67%	100.0%	66.67%	88.89%	88.89%	100.0%	55.56%
Cash Shortage	7	85.71%	14.29%	100.0%	57.14%	85.71%	71.43%	85.71%	57.14%

Some governments list more than one reason. *N* will not equal 98.

MD&A: Whether the government discloses Going Concern reasons in current year's MD&A section of its financial report.

PY_MD&A: Whether the government discloses Going Concern reasons in previous year's MD&A section of its financial report.

Notes: Whether the government discloses Going Concern reasons in current year's footnotes of its financial report.

PY_Notes: Whether the government discloses Going Concern reasons in prior year's footnotes of its financial report.

PY_AFR: Whether the government had a prior year annual financial report.

Had PY_MD_A: Whether the government had the MD&A section in its prior year's financial report.

GASB 34: Whether the government follows GASB No. 34.

Going Concern: Whether the government has a footnote labeled as going concern.

MD&A and 69% in the footnotes of the year prior to the going concern year. About 62% of the 13 AFRs in the category have a footnote entitled “Going Concern.” About 54% of these 13 AFRs adopted GASB 34.

Within the “legal” category, 100% of the nine AFRs disclose the issue in the MD&A and the footnotes of the going concern year, but only 34% of the nine AFRs disclose the issue in the MD&A and 66% of the nine AFRs disclose in the footnotes of the year prior to the going concern year. About 56% of nine AFRs in the category have a footnote titled “Going Concern.” All nine AFRs adopted GASB 34.

Out of seven cases in the category of “cash shortage,” about 86% of AFRs disclose the issue in the MD&A and 100% disclose similar information in the footnotes of the going concern year. However, only 14% of the seven cases disclose the issue in the MD&A and 57% of the seven cases disclose in the footnotes of the year prior to the going concern year. About 57% of the seven AFRs in the category have a footnote entitled “Going Concern.” About 86% of these seven AFRs adopted GASB 34.

It appears that the majority of AFRs disclose cash shortages and legal issues in the footnotes and MD&A sections during the current year. Other GCO-related issues are more likely to be disclosed in the footnotes than in the MD&A section of the current year. Almost all of the sample organizations that had MD&A sections in the previous year disclose GCO-related factors in the MD&A section for the current year. The proportion of AFRs that contains GCO-related factors declined substantially (except for Going Concern Given to Part of the Organization) the year before the organizations received GCOs.

Consistent with the literature that we cited previously, we find that “deficiency in funds” and “losses or revenue declines” are the top reasons that auditors cite for giving going concern opinions. Disclosure of going concern factors occurs more often in the notes than in the MD&A perhaps due to either the fact that not all of the sample have MD&A (see footnote 1) or management’s tendency to window dress performance in the MD&A and thus be less likely to disclose the distress there.

Auditors’ Justifications for Issuing Going Concern Opinions by Auditor Type

We performed several additional analyses regarding the going concern justifications. Specifically, we tested whether auditor justifications vary by auditor type, the size of the government, the type of government, and whether the audit opinion was rendered before or after GASB 56. To test whether differences in auditor justifications are statistically different, we performed chi-squared tests. If the p -value was sufficiently small, we reject the null hypothesis that the two variables are independent and conclude that there is an association between the frequency of the going concern reason that the auditor cited and auditor type, the size of the government, the type of government, and/or whether the audit opinion was rendered before or after GASB 56.

Our first supplemental analysis considers whether the going concern reporting varies by type of auditor. Tables 7 and 8 present the going concern justifications for state auditors and public accounting firms, respectively. For state auditors, the most cited reason for a going concern is “State Oversight,” followed by “Deficiency in Funds.” This is in contrast with the overall sample that had “State Oversight” cited as the third most common reason. For the top two reasons, the majority of the observations disclose in the current year MD&A, while all observations disclose

Table 7. Reasons for Going Concern, Governments Audited by the State

Going Concern Reason	N	MD&A	PY_MD&A	Notes	PY_Notes	PY_AFR	Had PY_MD&A	GASB 34	Going Concern	χ^2 Test of State & Public Accounting
Debt issues	0	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	4.09**
State oversight	16	62.50%	43.75%	100.0%	75.0%	100.0%	56.25%	62.5%	0%	27.86***
Legal	0	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	2.70
Going concern given to part of the organization	1	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	5.63**
Losses or revenue declines	3	66.67%	33.33%	66.67%	33.33%	100.0%	100.0%	100.0%	0%	8.91***
Deficiency in funds	9	77.78%	66.67%	100.0%	77.78%	100.0%	66.67%	66.67%	0%	0.05
Cash shortage	3	66.67%	0%	100.0%	66.67%	100.0%	66.67%	66.67%	0%	2.06

*, **, *** significant at the $p < 0.1$, $p < 0.05$, and $p < 0.01$ respectively.
 N/A refers to cases where reason was not cited at all (Not Applicable).

Table 8. Reasons for Going Concern, Governments Audited by a Public Accounting Firm

Going Concern Reason	N	MD&A	PY_MD&A	Notes	PY_Notes	PY_AFR	Had PY_MD&A	GASB 34	Going Concern
Debt Issues	13	30.77%	46.15%	84.62%	69.23%	69.23%	46.15%	53.85%	61.54%
State Oversight	13	53.85%	23.08%	100.0%	53.85%	84.62%	84.62%	92.31	38.46%
Legal	9	100.0%	66.67%	100.0%	66.67%	88.89%	88.89%	100.0%	55.56%
Going Concern Given to Part of the Organization	23	39.13%	30.43%	73.91%	73.91%	82.61%	65.22%	78.26%	52.17%
Losses or Revenue Declines	39	53.85%	43.59%	87.18%	53.85%	79.49%	51.28%	64.10%	51.28%
Deficiency in Funds	35	65.71%	48.57%	94.29%	65.71%	80.0%	51.43%	68.57%	45.71%
Cash Shortage	4	100.0%	25.0%	100.0%	50.0%	75.0%	75.0%	100.0%	100.0%

in the notes. There is a noticeable drop off in note disclosure in the prior year AFR for both “State Oversight” and “Deficiency in Funds.” The single largest drop occurred in “Cash Shortage” and “Losses or Revenue Declines,” which each, respectively, fell by a difference of 33.33%.

In contrast with state auditors, the most often cited reason for a going concern opinion issued by public accounting firms is “Losses or Revenue Declines,” followed by “Deficiency in Funds,” and “Going Concern Given to Part of the Organization.” While “State Oversight” was the leading reason cited by state auditors, “State Oversight” was only the fourth most cited reason for a going concern opinion given by public accounting firms. The chi-square test shows that the differences between state auditors and public accounting firms are statistically significant for “Debt Issues” ($p < 0.05$), “State Oversight” ($p < 0.01$), “Going Concern Given to Part of the Organization” ($p < 0.05$), and “Losses or Revenue Declines” ($p < 0.01$). Similar to state auditors, public accounting firms had considerably less disclosure in the year prior to receiving a going concern opinion. The largest decline in disclosure rate was for “Cash Shortage,” which went from 100% in the current year to 50% in the year prior to a going concern opinion being issued.

Auditors’ Justifications for Issuing Going Concern Opinions by Government Size

In our second supplemental analysis, we compared the going concern justifications of larger governments with those of smaller governments. Prior literature reports that larger entities have more resources than smaller ones, thus the going concern justifications may differ per entity size. We defined larger governments as those that have total governmental fund revenues greater than the median value (\$57 million) and those below as smaller governments. Tables 9 and 10 present the going concern justifications for these two size groups of governments respectively. For larger governments, the most cited reason for a going concern is “Deficiency in Funds,” followed by “Losses or Revenue Declines,” and “Going Concern Given to Part of the Organization.” This is consistent with the overall sample. For the top three reasons, the majority of the observations disclose in the current year MD&A, while over 90% disclose in the notes. There is a noticeable drop off in note disclosure in the prior year AFR for both “Deficiency in Funds” as well as “Losses or Revenue Declines.” The single largest drop occurs in “Losses or Revenue Declines” which goes from 95% to 65%.

In contrast with larger governments, the most cited reason for a going concern opinion for smaller governments is “Losses or Revenue Declines,” while “State Oversight” and “Deficiency in Funds” tie for the second most cited reason for a going concern opinion. The chi-square test demonstrates that the differences between large and small governments are statistically significant for both “State Oversight” ($p < 0.05$) and “Cash Shortage” ($p < 0.05$). Similar to larger governments, small governments have considerably less disclosure in the year prior to receiving a going concern opinion. For example, while all but one reason, “Going Concern Given to Part of the Organization,” have notable disclosure rates of at least 75% during the year when a going concern opinion was issued, in the prior year all note disclosure rates are 70% or below. “Losses or Revenue Declines” have the largest decrease, going from 77.27% to 40.91%.

The descriptive data suggest that going concern disclosure patterns seem to vary by government size. Future research incorporating additional data are needed to investigate the reasons behind these differences.

Table 9. Reasons for Going Concern, Government with Total Revenues Greater than \$57,401,013

Going Concern Reason	N	MD&A	PY_MD&A	Notes	PY_Notes	PY_AFR	Had PY_MD&A	GASB 34	Going Concern	χ^2 Test of Large & Small Governments
Debt Issues	5	40.0%	20.0%	100.0%	80.0%	60.0%	60.0%	60.0%	0.00%	0.80
State Oversight	9	33.33%	0.00%	100.0%	55.56%	100.0%	66.67%	66.67%	22.22%	5.93**
Legal	5	100.0%	80.0%	100.0%	80.0%	100.0%	100.0%	100.0%	20.0%	0.12
Going Concern Given to Part of the Organization	13	53.85%	46.15%	92.31%	92.31%	100.0%	100.0%	100.0%	30.77%	0.22
Losses or Revenue Declines	2	65.0%	60.0%	95.0%	65.0%	90.0%	65.0%	65.0%	35.0%	0.17
Deficiency in Funds	2	66.67%	58.33%	95.83%	79.17%	91.67%	58.33%	66.67%	20.83%	0.66
Cash Shortage	4	100.0%	0.00%	100.0%	0.0%	100.0%	100.0%	100.0%	100.0%	3.84**

*, **, *** significant at the $p < 0.1$, $p < 0.05$, and $p < 0.01$ respectively.

Table 10. Reasons for Going Concern, Governments with Total Revenues Less Than or Equal to \$57,401,013

Going Concern Reason	N	MD&A	PY_MD&A	Notes	PY_Notes	PY_AFR	Had PY_MD&A	GASB 34	Going Concern
Debt Issues	8	25.0%	25.0%	75.0%	62.50%	75.0%	37.50%	50.0%	100.0%
State Oversight	20	70.0%	50.0%	100.0%	70.0%	90.0%	70.0%	80.0%	15.0%
Legal	4	100.0%	50.0%	100.0%	50.0%	75.0%	75.0%	100.0%	100.0%
Going Concern Given to Part of the Organization	11	27.27%	18.18%	54.55%	54.55%	63.64%	27.27%	54.55%	81.82%
Losses or Revenue Declines	22	45.45%	27.27%	77.27%	40.91%	72.73%	45.45%	68.18%	59.09%
Deficiency in Funds	20	70.0%	45.0%	95.0%	55.0%	75.0%	50.0%	70.0%	55.0%
Cash Shortage	6	83.33%	16.67%	100.0%	66.67%	83.33%	66.67%	83.33%	50.0%

Auditors' Justifications for Issuing Going Concern Opinions by Government Type

In our third supplementary analysis, we compared the going concern justifications of 80 cities and 18 counties in the sample because the operations in cities and counties are very different and thus may receive going concerns for different reasons. Tables 11 and 12 present the going concern justifications for cities and counties, respectively. In contrast with the overall sample, the top two reasons cited for a going concern opinion for cities are “Losses or Revenue Declines” and “Deficiency in Funds,” and the third most cited reason is “State Oversight.” Consistent with the overall sample, reasons for going concern opinions were uniformly more likely to be disclosed in the notes versus the MD&A. Disclosure rates in the current AFR are quite high, with all reasons except “Going Concern Given to Part of the Organization” in excess of 80%. There is a noticeable drop off in prior year disclosure with all reasons except for “Debt Issues” and “Going Concern Given to Part of the Organization” suffering drops in disclosure rate in excess of 30%.

The counties findings conform to the overall sample, with “Deficiency in Funds” cited the most often and “Going Concern Given to Part of the Organization” and “Losses or Revenue Declines” tie for second. Disclosure rates for “Deficiency in Funds” are notably greater than for the rest of the county sample. The chi-square test demonstrates that the differences between cities and counties are statistically significant for “State Oversight” ($p < 0.10$). Factoring in whether a prior year AFR or prior MD&A was obtained for the government, we document disclosure rates of 90% or greater for both the notes and MD&A in the current year and prior year. All other reasons with the exception of “Cash Shortage” see disclosure rates of 50% or below.

Auditors' Justifications for Issuing Going Concern Opinions Before and After GASB 56

In our final supplementary analysis, we compared the going concern justifications given in the 53 auditor reports before GASB 56 (audit reports covering 2008 or earlier) and the 45 auditor reports since the enactment of GASB 56 (audit reports since 2009). As previously discussed, GASB 56 codified going concern guidance which may potentially alter the frequency, reasons, and disclosure of going concern opinions. Tables 13 and 14 present the going concern justifications for pre-GASB 56 and post-GASB 56, respectively. Consistent with the overall sample, the top three reasons cited for a going concern opinion pre- and post-GASB 56 are “Deficiency in Funds,” “Losses or Revenue Declines,” and “State Oversight.” In fact, the chi-square test shows that “Legal” is the only cited reason that is statistically different ($p < 0.10$) between the pre- and post-GASB 56 samples. Additionally, consistent with the overall sample, reasons for going concern opinions are uniformly more likely to be disclosed in the notes versus in the MD&A section. Interestingly, disclosure rates in the AFR are consistently higher post-GASB 56, suggesting an improved disclosure. Overall, while the reasons for giving a going concern opinion are largely consistent between the two time periods, disclosure rates improved post-GASB 56.

Summary and Conclusions

In this study, we have analyzed the reasons governments receive going concern opinions and the level of disclosure surrounding these reasons in the current year AFR and prior year AFR. In our sample of 98 going concern observations, we find that auditors most often cite “Deficiency in Funds” or “Losses or Revenue Declines” as reasons for giving a going concern opinion. Within “Deficiency in Funds,” we find that auditors most often cite negative fund balances in the general fund and enterprise fund as a reason to give a going concern opinion. Interestingly,

Table 11. Reasons for Going Concern, Cities (N=80)

Going Concern Reason	N	MD&A	PY_MD&A	Notes	PY_Notes	PY_AFR	Had PY_MD&A	GASB 34	Going Concern	χ^2 Test of Cities & Counties
Debt Issues	11	36.36%	27.27%	81.82%	72.73%	81.82%	54.55%	63.64%	72.73%	0.09
State Oversight	27	55.56%	33.33%	100.0%	66.67%	92.59%	66.67%	74.07%	18.52%	3.61*
Legal	9	100.0%	66.67%	100.0%	66.67%	88.89%	88.89%	100.0%	55.56%	2.23
Going Concern Given to Part of the Organization	18	50.0%	38.89%	72.22%	83.33%	88.89%	77.78%	83.33%	44.44%	0.93
Losses or Revenue Declines	36	61.11%	55.56%	91.67%	58.33%	83.33%	55.56%	66.67%	50.0%	0.82
Deficiency in Funds	34	61.76%	47.06%	97.06%	64.71%	85.29%	50.00%	61.76%	41.18%	1.01
Cash Shortage	6	83.33%	16.67%	100.0%	50.0%	83.33%	66.67%	83.33%	66.67%	0.08

*, **, *** significant at the p<0.1, p<0.05, and p<0.01 respectively.

Table 12. Reasons for Going Concern, Counties (N=18)

Going Concern Reason	N	MD&A	PY_MD&A	Notes	PY_Notes	PY_AFR	Had PY_MD&A	GASB 34	Going Concern
Debt Issues	2	0.0%	0.0%	100.0%	50.0%	0.0%	0.0%	0.0%	0.0%
State Oversight	2	100.0%	50.0%	100.0%	50.0%	100.0%	100.0%	100.0%	0.0%
Legal	0	0.00%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Going Concern Given to Part of the Organization	6	16.67%	16.67%	83.33%	50.0%	66.67%	33.33%	66.67%	83.33%
Losses or Revenue Declines	6	16.67%	0.0%	50.0%	16.67%	66.67%	50.0%	66.67%	33.33%
Deficiency in Funds	10	90.0%	70.0%	90.0%	80.0%	80.0%	70.0%	90.0%	20.0%
Cash Shortage	1	100.0%	0.0%	100.0%	100.0%	100.0%	100.0%	100.0%	0.0%

Table 13. Reasons for Going Concern, Pre GASB 56 (N=53)

Going Concern Reason	N	MD&A	PY_MD&A	Notes	PY_Notes	PY_AFR	Had PY_MD&A	GASB 34	Going Concern	χ^2 Test of Pre & Post GASB 56
Debt Issues	5	0.0%	0.0%	60.0%	40.0%	60.0%	0.0%	20.0%	100.0%	1.47
State Oversight	13	61.54%	38.46%	100.0%	61.54%	84.62%	46.15%	61.54%	76.92%	1.42
Legal	2	100.0%	50.0%	100.0%	50.0%	100.0%	100.0%	100.0%	50.0%	4.05**
Going Concern Given to Part of the Organization	12	8.33%	8.33%	66.67%	66.67%	83.33%	50.0%	58.33%	58.33%	0.21
Losses or Revenue Declines	22	40.91%	36.36%	72.73%	40.91%	72.73%	45.45%	59.09%	59.09%	0.09
Deficiency in Funds	24	62.5%	50.0%	91.67%	70.83%	83.33%	54.17%	66.67%	37.5%	0.01
Cash Shortage	2	100.0%	0.0%	100.0%	50.0%	100.0%	100.0%	100.0%	50.0%	1.98

*, **, *** significant at the $p < 0.1$, $p < 0.05$, and $p < 0.01$ respectively.

Table 14. Reasons for Going Concern, Post GASB 56 (N=45)

Going Concern Reason	N	MD&A	PY_MD&A	Notes	PY_Notes	PY_AFR	Had PY_MD&A	GASB 34	Going Concern
Debt Issues	8	50.0%	37.50%	100.0%	87.50%	75.0%	75.0%	75.0%	37.50%
State Oversight	16	56.25%	31.25%	100.0%	68.75%	100.0%	87.50%	87.50%	25.0%
Legal	7	100.0%	71.43%	100.0%	71.43%	85.71%	85.71%	100.0%	57.14%
Going Concern Given to Part of the Organization	12	75.0%	58.33%	83.33%	83.33%	83.33%	83.33%	100.0%	50.0%
Losses or Revenue Declines	20	70.0%	50.0%	100.0%	65.0%	90.0%	65.0%	75.0%	35.0%
Deficiency in Funds	20	75.0%	55.0%	100.0%	65.0%	85.0%	55.0%	70.0%	35.0%
Cash Shortage	5	80.0%	20.0%	100.0%	60.0%	80.0%	60.0%	80.0%	60.0%

while the media often details the pension woes of local governments, “unfunded pension liabilities” is cited in only two cases. Within “Losses or Revenue Declines,” the two most often cited reasons are recurring losses in the general fund, and recurring losses in an enterprise fund. Overall, our findings suggest the two funds most responsible for a going concern opinion are the general fund and the enterprise fund.

In reviewing the disclosures governments made concerning the reasons for the going concern opinion, we find that governments are more likely to disclose the reasons in the notes rather than in the MD&A. Governments are less likely to disclose the going concern reasons in their prior year AFR than in the current year AFR. In reviewing the note disclosures in the year a government receives a going concern opinion, we find that around half of the sample have a note disclosure specifically labeled as “Going Concern,” while the other half does not use this heading. Overall, we find most organizations are disclosing the reasons for receiving a going concern opinion in their AFRs with the most likely location being in the notes to the financial statements. We also find that going concern reporting varies by auditor type (state auditor vs. public accounting firm), government size (large vs. small government), and government type (city vs. county). In addition, we identify evidence that going concern disclosure rates improve after the enactment of GASB No. 56. One reason that disclosure of going concern factors is more frequent in the notes than in the MD&A is possibly due to not all of the sample having an MD&A (see footnote 1). Another plausible reason could be that management has a tendency to window dress performance in the MD&A and thus prefers to discuss financial distress in a footnote rather than in the MD&A.

Our study is not without limitations. As previously noted, we were unable to obtain AFRs for over half of the original sample. In addition, we were challenged in getting consecutive AFRs for sample governments. The data collection problems were particularly acute in the earlier sample periods. It also should be noted that the going concern assessment is particularly challenging in the government setting. A systematic way of identifying which governments should have received a going concern opinion does not currently exist. Our research is exploratory in nature focusing on descriptive analysis. Future research with sufficient data to conduct multivariate analyses is needed in order to address the causality of the disclosure patterns that are documented in this study.

The findings from this study should be informative to the GASB, as they consider future guidance regarding going concern opinions for local governments. A challenge will be to consider what triggers should exist before issuing a going concern opinion to a government. Unlike for-profit companies, few governments file for bankruptcy. As noted in this study, the reasons for receiving a going concern opinion are diverse (32 distinct reasons classified into seven broad categories are given for the sample of 98 going concern opinions), and future guidance will hopefully clarify when a going concern opinion is appropriate in the local government context.

Disclosure Statement

The authors declare that there are no conflicts of interest related to this research, authorship, or publication of this article.

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Appendix

Table A1. Going Concern Category Definitions

Category Name	Category Definition
Deficiency in Funds	Includes all going concern reasons pertaining to an insufficiently low level of funds.
Losses or Revenue Declines	Includes all going concern reasons pertaining to a reduction in funds.
State Oversight	Includes all going concern reasons resulting from direct state actions.
Going Concern Given to Part of the Organization	Includes all going concern reasons where the going concern opinion covers only part of the government (e.g.: component unit).
Debt Issues	Includes all going concern reasons citing failure to meet debt obligations.
Legal	Includes all going concern reasons involving court actions (e.g.: filing for bankruptcy).
Cash Shortage	Includes all going concern reasons that explicitly mention a lack of cash.