AUDITORS IN DISTRESSED FIRMS: DO THEY CONTRIBUTE TO THE GOING CONCERN? PRIMARY EVIDENCE FROM ITALY

Carla Morrone *, Marco Venuti **, Sergio Longobardi ***

* Department of Law and Economics of Production Activities, Sapienza University of Rome, Rome, Italy
** Department of Economics, Statistics and Business, Mercatorum University, Rome, Italy
*** Department of Business and Quantitative Studies, Parthenope University, Naples, Italy

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Abstract

Corporate governance (CG) mechanisms are essential elements in all types of business and thus they are also important in distressed firms. Scholars have studied them through different theories (e.g., resource dependency theory, agency theory, resource-based view) and approaches focusing on various aspects (e.g., board diversity, board size, type of control, etc.) (Alhossini et al., 2021; Dasilas & Rigani, 2024; Giannarakis et al., 2023; Morrone, Bianchi, et al., 2022; Morrone, Funaro, et al., 2023; Tron et al., 2023).

The aim of this research is to focus on statutory and external auditors to determine whether their appointment impacts the likelihood of distressed firms opting for a going concern procedure rather than a liquidation one.

The resource dependence theory recognizes audit as an influential mechanism of CG through which external resources supporting boards in their oversight activities can be acquired (Chenchehene, 2019), thus mitigating internal control issues (Appiah & Chizema, 2016).

Both internal and external auditors play a key role in ensuring the reliability of financial statements prepared by companies for investors (Bratten et al., 2013). Auditors scrutinize the financial statements and are required to assess the company's ability to continue as a going concern for the next 12 months. This implies that companies should receive a qualified audit report in the presence of significant financial difficulties (Geiger et al., 2005), thereby providing an early warning to the market about the company's situation.

Several studies find a relationship between audit opinion and financial distress (Li et al., 2008), and more generally between internal and external audit and financial distress (Appiah & Amon, 2017; Cenciarelli et al., 2018; Mohid Rahmat et al., 2009). However, there is limited literature, especially in Europe, regarding the relationship between the presence of statutory and external auditors and corporate financial difficulties (Tron et al., 2023).

To reach the research target, a quantitative analysis is performed on a sample of Italian companies that faced financial difficulties during the period 2013-2023, undergoing specific procedures (e.g., composition with creditors, bankruptcy, extraordinary administration).

An econometric analysis using a logistic regression model indicates that the appointment of auditors in the years before the legal procedure significantly influences the probability of a prompt activation of a going concern procedure, helping to reduce the risk of liquidation.

This study offers relevant implications for both academics and practitioners, but it is not free from limitations.

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