

Heads Up

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The proposed ASU extends the responsibility for performing the going-concern assessment from auditors to management.

Going Once, Going Twice . . . FASB Proposes Going-Concern Guidance

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On June 26, 2013, the FASB issued a [proposed ASU](#)¹ that would give entities guidance on determining when and how to disclose going-concern uncertainties in their financial statements. Under the proposal, management would be required to perform interim and annual assessments of an entity's ability to continue as a going concern within 24 months of the financial statement date. An entity would have to disclose uncertainties about such ability if (1) it is "more likely than not" (MLTN) — that is, a likelihood of more than 50 percent — that it will not be able to meet its obligations within 12 months of the financial statements or (2) if it is "*known or probable* that the entity will be unable to meet its obligations within 24 months after the financial statement date." The proposed ASU applies to all entities; however, a public entity would also have to assess whether there is "substantial doubt" about its ability to continue as a going concern and provide specific disclosures if that threshold is met. Comments on the proposal are due by September 24, 2013.

This *Heads Up* provides background on the proposed ASU and summarizes its key provisions. [Appendix A](#) contains decision flowcharts from the proposal that summarize going-concern disclosure considerations. [Appendix B](#) lists the proposal's questions for respondents.

Background

Under U.S. GAAP, an entity's financial reports reflect its assumption that it will continue as a going concern until liquidation is imminent.² However, before liquidation is deemed imminent, an entity may have uncertainties about its ability to continue as a going concern. Because there are no specific requirements under U.S. GAAP related to disclosing such uncertainties, auditors are responsible for assessing the nature, timing, and extent of an entity's disclosures on the basis of applicable auditing standards.³ Such application has resulted in diversity in practice, which the proposal aims to alleviate.

The proposed ASU extends the responsibility for performing the going-concern assessment from auditors (as required under current auditing standards⁴) to management and contains guidance on how to perform a going-concern assessment and when going-concern disclosures would be required under U.S. GAAP. The Board believes that requiring management to perform the assessment will (1) enhance the timeliness, clarity, and consistency of related disclosures and (2) improve convergence with IFRSs (under which management's responsibility for performing the going-concern assessment is emphasized). However, the time horizon of the assessment and disclosure thresholds under U.S. GAAP and IFRSs would continue to differ.

¹ FASB Proposed Accounting Standards Update, *Disclosure of Uncertainties About an Entity's Going Concern Presumption*.

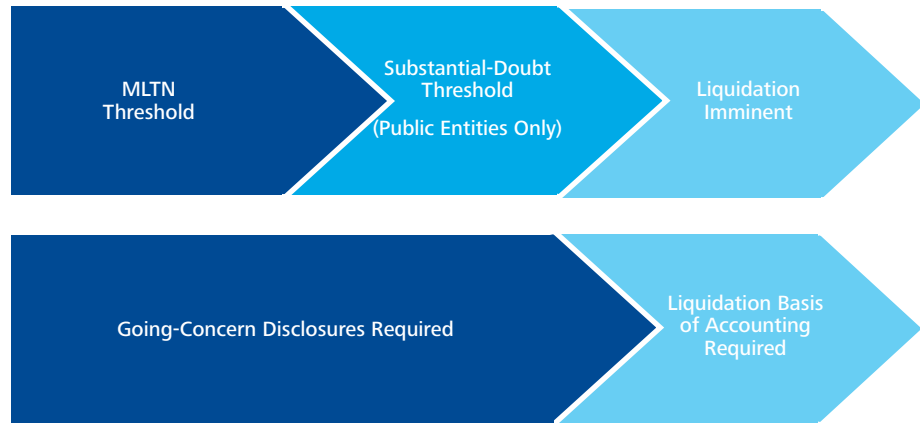
² In accordance with FASB Accounting Standards Codification Subtopic 205-30, *Presentation of Financial Statements: Liquidation Basis of Accounting*, once liquidation is deemed imminent, an entity must apply the liquidation basis of accounting.

³ PCAOB AU Section 341A, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.

⁴ PCAOB AU Section 341A.02.

Key Provisions of the Proposed ASU

Disclosure Thresholds



The MLTN threshold is not intended to be a “formula-based likelihood calculation”; rather, it is a “benchmark” in the determination of whether disclosures are required.

As noted above, an entity would be required to disclose information about its potential inability to continue as a going concern when either:

- a. It is **more likely than not** that the entity will be unable to meet its obligations within **12 months** after the financial statement date. . . . [or]
- b. It is **known or probable** that the entity will be unable to meet its obligations within **24 months** after the financial statement date. [Emphasis added]

In applying the disclosure threshold outlined in (a) and (b) above, entities would be required to evaluate all conditions and events (including positive and mitigating conditions) except for management’s plans that are outside the ordinary course of business.⁵

In addition, the proposed ASU indicates that the MLTN threshold is not intended to be a “formula-based likelihood calculation”; rather, it is a “benchmark” in the determination of whether disclosures are required. The proposal provides examples of events that suggest that an entity may be unable to meet its obligations. These examples, which are consistent with those in auditing literature,⁶ include the following:

- a. Negative trends, for example, recurring operating losses, working capital deficiencies, negative cash flows from operating activities, and adverse key financial ratios
- b. Other indications of possible financial difficulties, for example, default on loans or similar agreements, arrearages in dividends, denial of usual trade credit from suppliers, restructuring debt to avoid default, noncompliance with statutory capital requirements, and a need to seek new sources or methods of financing or to dispose of substantial assets
- c. Internal matters, for example, work stoppages or other labor difficulties, substantial dependence on the success of a particular project, uneconomic long-term commitments, and a need to significantly revise operations
- d. External matters that have occurred, for example, legal proceedings, legislation, or similar matters that might jeopardize the entity’s ability to operate; loss of a key franchise, license, or patent; loss of a principal customer or supplier; and an uninsured or underinsured catastrophe such as a hurricane, tornado, earthquake, or flood.

Editor’s Note: Under current auditing standards, an auditor is required to evaluate the adequacy of going-concern disclosures **after** concluding that there is substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time. Accordingly, the MLTN threshold may result in an entity’s having to disclose uncertainties about its ability to continue as a going concern earlier than is required under current practice.

⁵ The proposal defines actions that are “outside the ordinary course of business” as those “of a nature, magnitude, or frequency that are inconsistent with actions customary in carrying out an entity’s ongoing business activities.” The proposal also provides examples of management’s plans that are outside the ordinary course of business.
⁶ PCAOB AU Section 341A.06.

Nonpublic entities would not be required to perform the substantial-doubt assessment.

In addition, a public entity would be required to evaluate whether there is substantial doubt about its ability to continue as a going concern. According to the proposal, substantial doubt “exists when information about existing conditions and events . . . indicates that it is known or probable that an entity will be unable to meet its obligations as they become due within 24 months after the financial statement date.” Unlike the disclosure threshold outlined above, the substantial-doubt assessment takes into account management’s plans outside the ordinary course of business. Nonpublic entities would not be required to perform the substantial-doubt assessment.

Time Horizon

Each reporting period (including interim periods), an entity would be required to assess its ability to meet its obligations as they become due for up to 24 months after the financial statement date. In the 12 months after the financial statement date, the entity would assess whether it is MLTN that it would not be able to meet its obligations. Beyond 12 months, the entity would consider only information about events or conditions whose impact is “known or probable” to the entity’s going-concern presumption.

Editor’s Note: The proposal’s assessment period is longer than that in current auditing literature, which requires auditors to “evaluate whether there is substantial doubt about an entity’s ability to continue as a going concern for a reasonable period of time, . . . **not to exceed one year** beyond the date of the financial statements being audited” (emphasis added).⁷

Disclosure Content

The disclosure requirements in the proposed ASU closely align with those under current auditing literature.⁸ If an entity triggers the MLTN threshold, it would be required to provide footnote disclosures that describe the following:

- a. Principal conditions and events that give rise to the entity’s potential inability to meet its obligations
- b. The possible effects those conditions and events could have on the entity
- c. Management’s evaluation of the significance of those conditions and events [and any mitigating factors]
- d. Mitigating conditions and events
- e. Management’s plans that are intended to address the entity’s potential inability to meet its obligations.

The proposal explains that these disclosures may change over time as new information becomes available.

In addition, if a public entity determines that there is substantial doubt about its ability to continue as a going concern within 24 months after the financial statement date, the entity would be required to specifically disclose that it has such doubt by using specific wording described in the proposal.⁹

Effective Date

The guidance in the proposal would be applied prospectively for reporting periods after the final standard’s effective date, which has not yet been established.

⁷ PCAOB AU Section 341A.02.

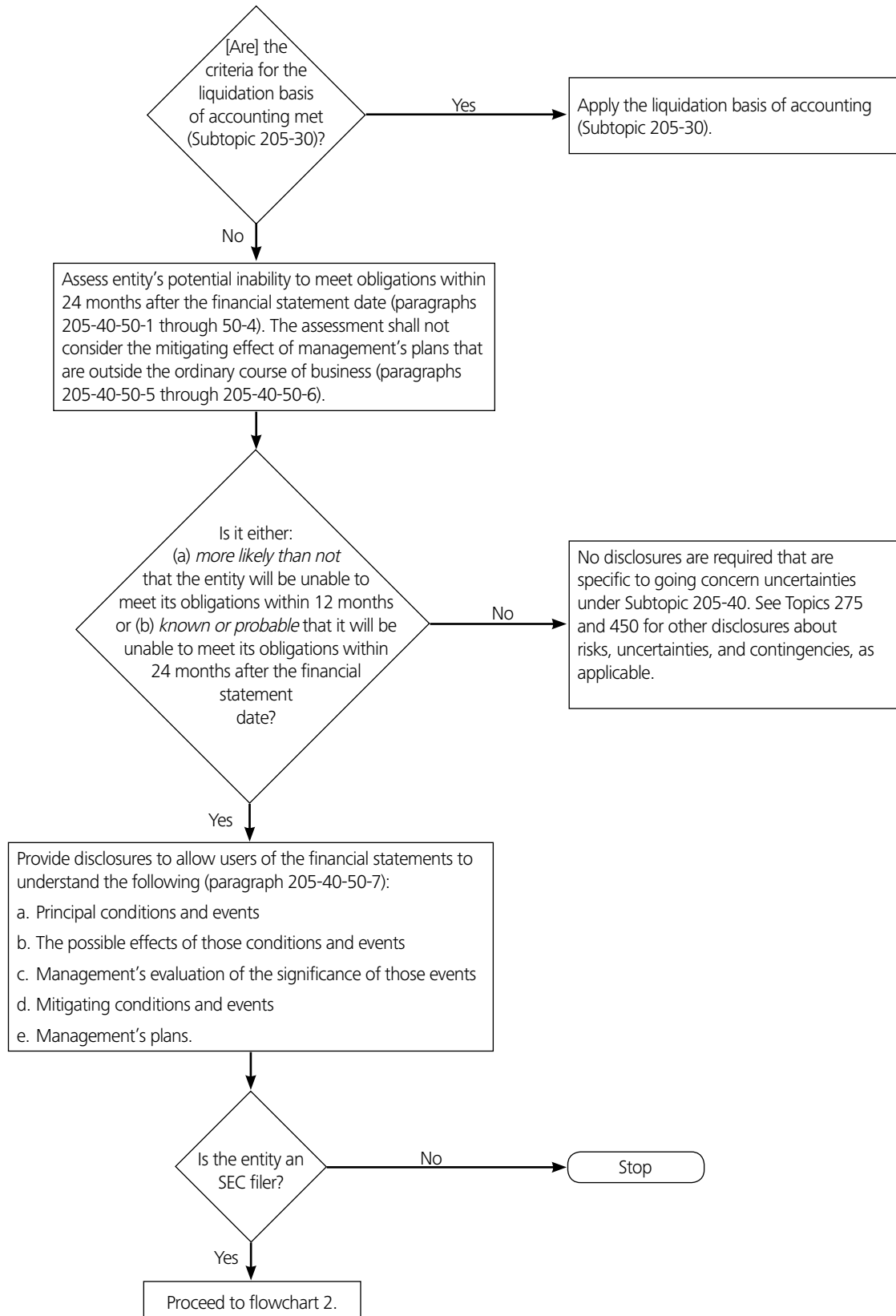
⁸ PCAOB AU Section 341A.10.

⁹ Under the proposal, if an SEC filer “determines that there is substantial doubt about its going concern presumption, the entity shall disclose that determination in its financial statements through the use of the phrase *there is substantial doubt about the entity’s ability to continue as a going concern within 24 months after the financial statement date* or similar wording that includes the terms *substantial doubt*, and *ability to continue as a going concern* or *ability to prepare financial statements under the going concern presumption*.”

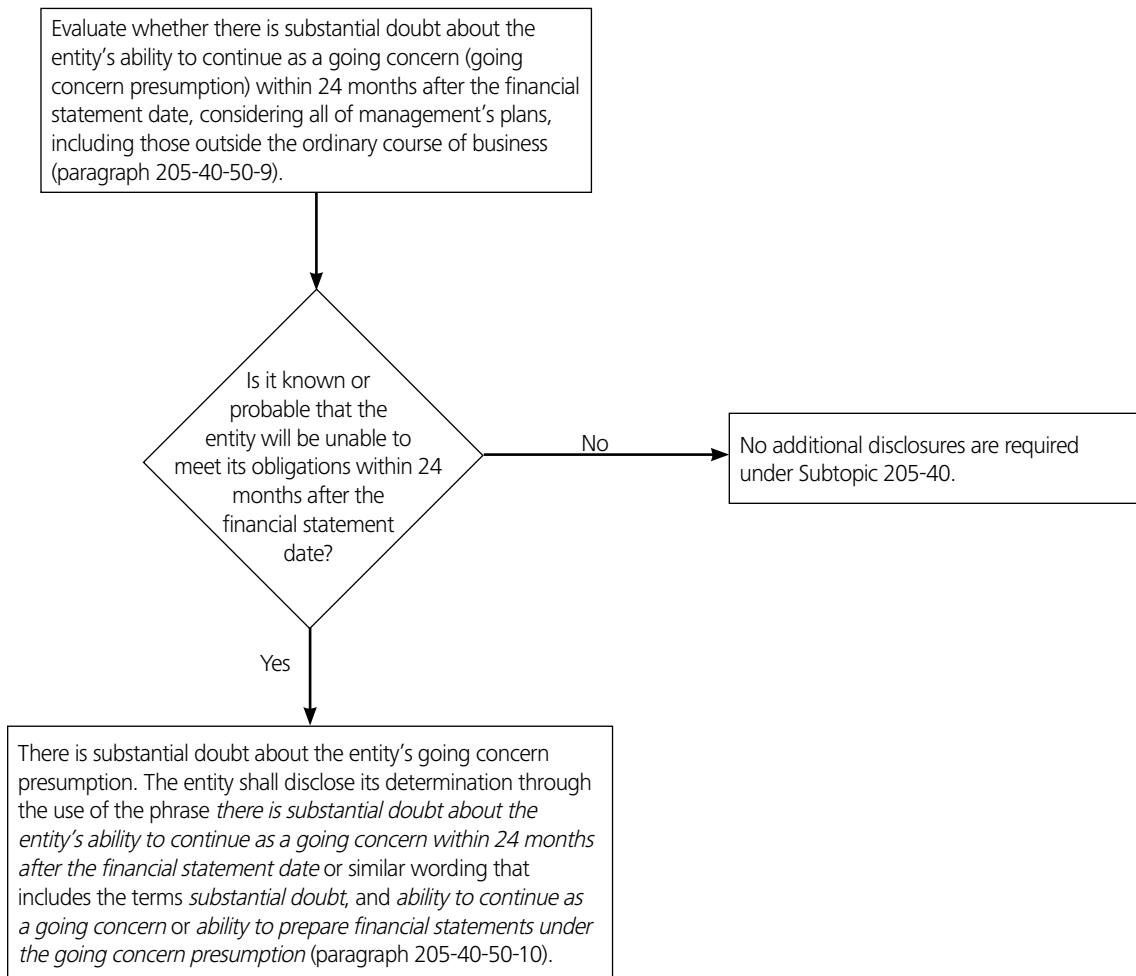
Appendix A — Decision Flowcharts

The flowcharts below are reproduced from the proposed ASU. The first depicts the decision process an entity would use in determining whether going-concern disclosures are required. The second clarifies specific disclosure considerations for entities that file with the SEC.

Flowchart 1 (for All Entities)



Flowchart 2 (for SEC Filers After Applying Flowchart 1)



Appendix B — Questions for Respondents

The questions for respondents below are reproduced from the proposed ASU and are included here for reference.

Overall

Question 1: The proposed amendments would define *going concern presumption* as the inherent presumption in preparing financial statements under U.S. GAAP that an entity will continue to operate such that it will be able to realize its assets and meet its obligations in the ordinary course of business. Do you agree with this definition? If not, what definition should be used and why?

Question 2: Currently, auditors are responsible under the auditing standards for assessing going concern uncertainties and for assessing the adequacy of related disclosures. However, there is no guidance in U.S. GAAP for preparers as it relates to management's responsibilities. Should management be responsible for assessing and providing footnote disclosures about going concern uncertainties? If so, do you agree that guidance should be provided in U.S. GAAP about the timing, nature, and extent of footnote disclosures about going concern uncertainties for SEC registrants and other entities? Why or why not?

Question 3: Would the proposed amendments reduce diversity in the timing, nature, and extent of footnote disclosures and provide relevant information to financial statement users? If so, would the proposed disclosures for SEC registrants provide users with incremental benefits relative to the information currently provided under other sections of U.S. GAAP and under the SEC's disclosure requirements?

Question 4: The proposed amendments would require management to evaluate going concern uncertainties and additionally, for SEC filers, to evaluate whether there is substantial doubt about the entity's ability to continue as a going concern. An alternative view is that such evaluations should not be required because management would inherently be biased and, thus, the resulting disclosures would provide little incremental benefit to investors. Do you believe that an entity's management has the objectivity to assess and provide disclosures of uncertainties about the entity's ability to continue as a going concern? Why or why not? If not, please also explain how this assessment differs from other assessments that management is required to make in the preparation of an entity's financial statements.

Question 5: At each reporting period, including interim periods, the proposed amendments would require management to evaluate an entity's going concern uncertainties. Do you agree with the proposed frequency of the assessment? If not, how often should the assessment be performed?

Question 6: For SEC registrants, the proposed footnote disclosures would include aspects of reporting that overlap with certain SEC disclosure requirements (including those related to risk factors and MD&A, among others). The Board believes that the proposed footnote disclosures would have a narrower focus on going concern uncertainties compared with the SEC's disclosure requirements. Do you agree? Why or why not? What differences, if any, will exist between the information provided in the proposed footnote disclosures and the disclosures required by the SEC? Is the redundancy that would result from this proposal appropriate? Why or why not?

Question 7: For SEC registrants, would the proposed footnote disclosure requirements about going concern uncertainties have an effect on the timing, content, or communicative value of related disclosures about matters affecting an entity's going concern assessment in other parts of its public filings with the SEC (such as risk factors and MD&A)? Please explain.

Question 8: The proposed footnote disclosures about going concern uncertainties would result in disclosure of some forward-looking information in the footnotes. What challenges or consequences, if any, including changes in legal liability for management and its auditors, do you anticipate entities may encounter in complying with the proposed disclosure guidance? Do you foresee any limitations on the type of information that preparers would disclose in the footnotes about going concern uncertainties? Would a higher threshold for disclosures address those concerns?

Question 9: What challenges, if any, could auditors face if the proposed amendments are adopted?

Question 10: Do the expected benefits of the proposed amendments outweigh the incremental costs of applying them?

Disclosure Threshold

Question 11: Under the proposed amendments, disclosures would start at the *more-likely-than-not* or at the *known or probable* threshold as described in paragraph 205-40-50-3.

- a. Is the disclosure threshold appropriate? What are the challenges in assessing the likelihood of an entity's potential inability to meet its obligations for purposes of determining whether disclosures are necessary?
- b. Are there differences between assessing probability in the context of transactions and assessing probability in the context of the overall state of an entity that are meaningful to determining the appropriateness of a probability model for assessing substantial doubt?

- c. Do the proposed amendments adequately contemplate qualitative considerations? Why or why not?
- d. Do you believe that the guidance in paragraph 205-40-50-4 about information on how an entity should assess the likelihood of its potential inability to meet its obligations and the implementation guidance within the proposed amendments are helpful and appropriate? Why or why not?
- e. Are your views the same for SEC registrants and non-SEC registrants?

Question 12: The proposed amendments would require an entity to assess its potential inability to meet its obligations as they become due for a period of 24 months after the financial statement date. Is this consideration period appropriate? Is it appropriate to distinguish the first 12 months from the second 12 months as proposed in the amendments? Why or why not?

Question 13: Under the proposed amendments, management would be required to distinguish between the mitigating effect of management's plans in and outside the ordinary course of business when evaluating the need for disclosures. Is this distinction relevant to determining if and when disclosures should be made? If so, explain how management's plans should be considered when defining the two different disclosure thresholds.

Question 14: Do you agree with the definition of *management's plans that are outside the ordinary course of business* as outlined in paragraph 205-40-50-5 and the related implementation guidance?

Question 15: Do you agree with the nature and extent of disclosures outlined in paragraph 205-40-50-7? Should other disclosure principles be included?

Substantial Doubt Determination

Question 16: The proposed amendments define *substantial doubt* as existing when information about existing conditions and events, after considering the mitigating effect of management's plans (including those outside the ordinary course of business), indicates that it is known or probable that an entity will be unable to meet its obligations within a period of 24 months after the financial statement date. Do you agree with this likelihood-based definition for substantial doubt? Do you agree with the 24-month consideration period? Why or why not? Do you anticipate any challenges with this assessment? If so, what are those challenges?

Question 17: Do you agree that an SEC filer's management, in addition to disclosing going concern uncertainties, should be required to evaluate and determine whether there is substantial doubt about an entity's ability to continue as a going concern (going concern presumption) and, if there is substantial doubt, disclose that determination in the footnotes?

Question 18: Do you agree with the Board's decision not to require an entity that is not an SEC filer to evaluate or disclose when there is substantial doubt about its going concern presumption? If not, explain how users of non-SEC filers' financial statements would benefit from a requirement for management to evaluate and disclose substantial doubt.

Question 19: The Board notes in paragraph BC36 that its definition of *substantial doubt* most closely approximates the upper end of the range in the present interpretation of substantial doubt by auditors. Do you agree? Why or why not? Assuming it does represent the upper end of the range of current practice, how many fewer substantial doubt determinations would result from the proposed amendments? If the proposed amendments were finalized by the Board and similar changes were made to auditing standards, would the occurrence of audit opinions with an emphasis-of-matter paragraph discussing going concern uncertainties likewise decrease and be different from what is currently observed? If so, by how much? Is such a decrease an improvement over current practice? Why or why not?

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