

---

**STANDING ADVISORY GROUP MEETING**

**PANEL DISCUSSION – GOING CONCERN**

**APRIL 2, 2009**

---

**Introduction**

At the April 2009 meeting of the Standing Advisory Group ("SAG"), a panel will discuss matters relating to the auditor's consideration of an entity's ability to continue as a going concern.

Historically, the U.S. requirements to evaluate an entity's ability to continue as a going concern have resided in the auditing standards.<sup>1/</sup> On October 9, 2008, the Financial Accounting Standards Board ("FASB") issued a proposed accounting standard, *Going Concern*, to require that the entity itself assess its ability to continue as a going concern.<sup>2/</sup>

In addition, recent events in the financial markets and the current economic environment have highlighted the importance of evaluating an entity's ability to continue

---

<sup>1/</sup> AU sec. 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*. References to AU sections ("AU secs.") throughout this paper are to the PCAOB's interim auditing standards, which consist of generally accepted auditing standards, as described in the AICPA Auditing Standards Board's Statement of Auditing Standards No. 95, as in existence on April 16, 2003, to the extent not superseded or amended by the Board. These standards are available on the PCAOB's Web site at [www.pcaobus.org](http://www.pcaobus.org)

<sup>2/</sup> Proposed Statement of Financial Accounting Standards, *Going Concern* (October 9, 2008). See Attachment A for the proposed accounting standard.

This paper was developed by the staff of the Office of the Chief Auditor to foster discussion among the members of the Standing Advisory Group. It is not a statement of the Board; nor does it necessarily reflect the views of the Board or staff

as a going concern.<sup>3/</sup> At the October 22-23, 2008 SAG meeting, the Standing Advisory Group discussed audit considerations relating to the current economic environment. As a result of that SAG discussion, the staff issued PCAOB Staff Audit Practice Alert No. 3, *Audit Considerations in the Current Economic Environment*, in December 2008 to assist auditors in identifying audit risks and other issues related to the current economic environment, including the importance of evaluating an entity's ability to continue as a going concern.<sup>4/</sup>

At the April 2009 meeting, the SAG discussion will address the potential effects of the current economic environment and the FASB proposed accounting standard on the auditor's responsibilities under the standards of the PCAOB, including, in particular, AU sec. 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*. The panel, consisting of a FASB representative, two auditors, and an academic, will present background information regarding the going concern topic. After the panelists' remarks, the SAG will have an opportunity for further discussion on the auditor's considerations regarding the issuer's ability to continue as a going concern.

This briefing paper provides a summary of the auditor's current responsibilities and background information on the FASB's proposed accounting standard. The briefing paper focuses on five discussion topics: (1) the time period for assessing going concern, (2) the audit procedures for evaluating an entity's ability to continue as a going concern, (3) evaluating an entity's projections and forecasts, (4) the explanatory paragraph in the auditor's report, and (5) general considerations.

## **Background**

The going concern assumption is the assumption that an entity has the financial ability to continue to operate. AU sec. 341.01 provides that continuation of an entity as a going concern is assumed in financial reporting in the absence of significant information

---

<sup>3/</sup> According to data from Audit Analytics, which includes 10-K, 20-F, and 40-F filings for fiscal year-ends from June 30, 2008 to December 31, 2008 filed as of March 12, 2009, over 23 percent of the filings include a going concern opinion. Comparatively, less than 20 percent of filings for fiscal year-ends from June 30, 2007 to December 31, 2007 that were made as of March 12, 2008 included a going concern opinion. This represents approximately a 19 percent increase in going concern opinions.

<sup>4/</sup> See [http://www.pcaobus.org/Standards/QandA/12-05-2008\\_APA\\_3.pdf](http://www.pcaobus.org/Standards/QandA/12-05-2008_APA_3.pdf)

to the contrary.<sup>5/</sup> AU sec. 341 imposes on the auditor a responsibility 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.<sup>6/</sup> AU sec. 341 also discusses the effect that substantial doubt might have on the financial statements and disclosures, including information that might be disclosed regarding the entity's ability to continue as a going concern for a reasonable period of time.<sup>7/</sup>

Currently, U.S. GAAP states that "[i]t should be emphasized that financial statements of a going concern are prepared on the assumption that the company will continue in business."<sup>8/</sup> The FASB proposed accounting standard's objective is to "provide guidance on the preparation of financial statements as a going concern and on management's responsibility to evaluate a reporting entity's ability to continue as a going concern."<sup>9/</sup> The proposed standard also would require certain disclosures either when financial statements are not prepared on a going concern basis or when there is substantial doubt as to an entity's ability to continue as a going concern. The FASB's

---

<sup>5/</sup> See Attachment B for the text of AU sec. 341. In March 2009, the International Auditing and Assurance Standards Board ("IAASB") issued International Standard on Auditing, ISA 570, *Going Concern*, ("ISA 570") to reflect new conventions that the IAASB is using in drafting auditing standards. See Attachment C for the text of ISA 570. The PCAOB staff would consider the ISA 570 requirements as part of a standards-setting project on going concern.

<sup>6/</sup> AU sec. 341.02. The Securities Exchange Act of 1934 also requires audits that are mandated by the statute to include "an evaluation of whether there is substantial doubt about the ability of the issuer to continue as a going concern during the ensuing fiscal year." 15 U.S.C. § 78j-1(a)(3).

<sup>7/</sup> For example, AU sec. 341.12 states that "[i]f, after considering identified conditions and events and management's plans, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains, the audit report should include an explanatory paragraph to reflect that conclusion."

<sup>8/</sup> Accounting Research Bulletin No. 43, *Restatement and Revision of Accounting Research Bulletins*, Chapter 3, paragraph 2.

<sup>9/</sup> Proposed Statement of Financial Accounting Standards, *Going Concern* (October 9, 2008), p iv.

proposal is based on certain requirements in AU sec. 341.<sup>10/</sup> One notable exception though is that the FASB proposal incorporates the time period for assessing an entity's ability to continue as a going concern as described in the International Accounting Standards Board International Accounting Standard ("IAS") No. 1, *Presentation of Financial Statements*, which is longer than the time period requirement in AU sec. 341.

## Discussion Topics

### Time period for assessing going concern

The FASB's proposed accounting standard on going concern aligns with IAS No. 1's requirement that management assess the entity's ability to continue as a going concern. Under both accounting standards, the entity will be required to assess its ability to continue as a going concern for a reasonable period, which is at least, but not limited to, twelve months from the date of the financial statements.<sup>11/</sup>

The time period identified in those standards, however, is different from the time period the auditor uses in evaluating going concern under the Board's auditing standard. AU sec. 341.02 imposes on the auditor a responsibility to evaluate whether there is substantial doubt about the 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.<sup>12/</sup> The PCAOB is considering proposing changes that would conform its auditing standard to the requirements in the FASB's proposed accounting standard.

---

<sup>10/</sup> Specifically, the FASB proposal incorporated paragraphs .06, .07, and .10 of AU sec. 341.

<sup>11/</sup> On February 18, 2009 the FASB discussed issues raised in comments received on the going concern proposal. Regarding the time period related to management's assessment, the Board decided "to clarify that the time period for the going concern assessment is not a bright-line 12 months but also is not intended to be an indefinite look-forward period." Additionally, the Board directed the staff to proceed to a draft of a final statement for vote by written ballot. The Board decided that the final statement will be effective for interim or annual periods ending after June 15, 2009. [See http://72.3.243.42/project/going\\_concern.shtml](http://72.3.243.42/project/going_concern.shtml).

<sup>12/</sup> ISA 570 uses the same time period as IAS No. 1 and the FASB proposed accounting statement. See paragraph 13.

**Discussion Question –**

1. If the time period that an auditor would use to evaluate an entity's ability to continue as a going concern is extended beyond the twelve-month period following the end of the fiscal year as required by Board's auditing standards, how would that affect the overall audit of an issuer?

**Audit procedures for evaluating an entity's ability to continue as a going concern**

AU sec. 341.05, states that it "is not necessary to design audit procedures solely to identify conditions and events that, when considered in the aggregate, indicate there could be substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time," and that "results of auditing procedures performed to achieve other audit objectives should be sufficient for that purpose." However, the auditor should evaluate whether information that comes to the auditor's attention as a result of all the audit procedures performed indicates there could be substantial doubt about the entities ability to continue as a going concern.<sup>13/</sup>

**Discussion Question –**

2. Should the PCAOB standard on going concern require the auditor to perform procedures specifically designed to identify conditions and events that indicate that there is substantial doubt about a company's ability to continue as a going concern for a reasonable period of time? If so, what types of specific procedures should the auditor perform in this regard?

**Evaluating an entity's projections and forecasts**

AU sec. 341.07 requires the auditor to consider management's plans for dealing with the adverse effects of conditions and events that indicate that there is substantial doubt about the entity's ability to continue as a going concern. When prospective financial information is "particularly significant" to management's plans, AU sec. 341.09 requires the auditor to request that management to provide the information and to consider the adequacy of support for significant assumptions underlying that information. AU sec. 341.09 also states that the auditor's consideration should include (a) reading the prospective financial information and the underlying assumptions and (b)

---

<sup>13/</sup> Compare ISA 570, paragraphs 14 and 15.

comparing prospective financial information in prior periods with actual results and comparing prospective information for the current period with results achieved to date.<sup>14/</sup>

**Discussion Question –**

3. What should the auditor's responsibilities be for evaluating an entity's assumptions, such as projected cash flows underlying a forecast, when mitigation of the adverse effects of events or conditions is based on management's forecast?

**Explanatory paragraph in the auditor's report**

After considering the identified conditions and events and management's plans for mitigating the adverse effects, the auditor may conclude that substantial doubt about the entity's ability to continue as a going concern remains. If so, AU sec. 341.12 requires the auditor to include an explanatory paragraph in the audit report.<sup>15/</sup> The standard indicates that the auditor's conclusion about the entity's ability to continue as a going concern should be expressed through the use of the phrase "substantial doubt about its (the entity's) ability to continue as a going concern" [or similar wording that includes the terms 'substantial doubt' and 'going concern'].<sup>16/</sup> AU sec. 341.13 includes the following example of such explanatory paragraph:

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency that raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note X. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

---

<sup>14/</sup> Compare ISA 570, paragraph 16.

<sup>15/</sup> Compare ISA 570, paragraph 19.

<sup>16/</sup> AU sec. 314.12. AU sec. 341.14 also provides that, if the entity's disclosures with respect to its ability to continue as a going concern for a reasonable period of time are inadequate, a departure from GAAP exists. This may result in either a qualified or an adverse audit opinion.

The FASB's proposed accounting standard would require the company to make certain disclosures either when financial statements are not prepared on a going concern basis or when there is substantial doubt as to an entity's ability to continue as a going concern. The PCAOB is considering retaining the explanatory paragraph in the auditor's report to highlight the going concern issue even if the entity is required to make such disclosures.

**Discussion Question –**

4. If the FASB's proposal to require disclosure about an entity's ability to continue as a going concern is adopted, what, if any, changes should be made to the explanatory paragraph in the auditor's report relating to going concern? For example, should the explanatory paragraph be retained substantially in its current form? Should additional information be added to the explanatory paragraph and, if so, what information? Or should the explanatory paragraph refer only to management's disclosures and conclusions as described in the notes to the financial statements?

**General Considerations**

The Board is interested in any other ideas or thoughts the SAG has on how to improve the auditing standard on going concern.

**Discussion Question –**

5. What additional changes to the auditing standard on going concern should be considered to assist auditors in conducting an audit of an issuer?

\* \* \*

The PCAOB is a private-sector, non-profit corporation, created by the Sarbanes-Oxley Act of 2002, to oversee the auditors of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, fair, and independent audit reports.

NO. 1650-100 | OCTOBER 9, 2008

# Financial Accounting Series

EXPOSURE DRAFT

## Proposed Statement of Financial Accounting Standards

### Going Concern

This Exposure Draft of a proposed Statement of Financial Accounting Standards is issued by the Board for public comment. Written comments should be addressed to:

Technical Director  
File Reference No. 1650-100

Comment Deadline: December 8, 2008

Financial Accounting Standards Board  
of the Financial Accounting Foundation

Responses from interested parties wishing to comment on the Exposure Draft must be **received** in writing by December 8, 2008. Interested parties should submit their comments by email to [director@fasb.org](mailto:director@fasb.org), File Reference No. 1650-100. Those without email may send their comments to the “Technical Director—File Reference No. 1650-100” at the address at the bottom of this page. Responses should **not** be sent by fax.

All comments received by the FASB are considered public information. Those comments will be posted to the FASB’s website and will be included in the project’s public record.

An electronic copy of this Exposure Draft is available on the FASB’s website until the FASB issues a final document. Any individual or organization may obtain one copy of this Exposure Draft without charge until December 8, 2008, on written request only. **Please ask for our Product Code No. E201.** For information on applicable prices for additional copies and copies requested after December 8, 2008, contact:

Order Department  
Financial Accounting Standards Board  
401 Merritt 7  
PO Box 5116  
Norwalk, CT 06856-5116

Copyright © 2008 by Financial Accounting Standards Board. All rights reserved. Permission is granted to make copies of this work provided that such copies are for personal or intraorganizational use only and are not sold or disseminated and provided further that each copy bears the following credit line: “Copyright © 2008 by Financial Accounting Standards Board. All rights reserved. Used by permission.”

Financial Accounting Standards Board  
of the Financial Accounting Foundation  
401 Merritt 7, PO Box 5116, Norwalk, Connecticut 06856-5116

**Notice for Recipients  
of This Exposure Draft**

This proposed Statement would provide guidance on the preparation of financial statements as a going concern and on management's responsibility to evaluate a reporting entity's ability to continue as a going concern. It also would require certain disclosures when either financial statements are not prepared on a going concern basis or when there is substantial doubt as to an entity's ability to continue as a going concern. Currently, AU Section 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, of the AICPA Codification of Statements on Auditing Standards contains the guidance about the going concern assessment. The Public Company Accounting Oversight Board (PCAOB) adopted AU Section 341 on an initial, transitional basis and has subsequently amended that interim standard.

The FASB is responsible for establishing standards that guide the overall presentation of an entity's financial statements and related disclosures. The Board believes that accounting guidance about the going concern assumption should be directed specifically to management of a reporting entity because management is responsible for preparing an entity's financial statements and evaluating its ability to continue as a going concern. Accordingly, the Board concluded that guidance about the going concern assumption also should reside in the accounting literature established by the FASB and decided to issue this proposed Statement.

The Board decided to carry forward the going concern guidance from AU Section 341, subject to several modifications to align the guidance with International Financial Reporting Standards (IFRSs). One of those modifications is to change the time horizon for the going concern assessment. AU Section 341 states that there is "a responsibility to evaluate whether there is substantial doubt about the 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" (paragraph .02). International Accounting Standard (IAS) 1, *Presentation of Financial Statements*, requires that an entity consider "all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period" (paragraph 26) when assessing whether the going concern assumption is appropriate. The Board decided to use the time horizon in IAS 1 because it avoids the inherent problems that a bright-line time horizon would create for events or conditions occurring just beyond the one-year time horizon that are significant and most likely would have to be disclosed.

The other modifications to align the going concern guidance with IFRSs include (1) using the wording in IAS 1 with respect to the type of information that should be considered in making the going concern assessment (*all available information about the future*) and (2) requiring an entity to disclose when it does not present financial statements on a going concern basis. The Board thinks there is no substantial difference between the wording in IAS 1 and the wording previously included in AU Section 341 with respect to the type of information that should be considered in making the going concern assessment. Therefore, the Board does not expect this modification to result in a change to practice.

## **Information for Respondents**

The Board invites individuals and organizations to send written comments on all matters in this proposed Statement, particularly on the issues listed below. Respondents need not comment on each issue and are encouraged to comment on additional matters that they believe should be brought to the Board's attention. Comments are requested from those who agree with the provisions of this proposed Statement and from those who do not.

Comments are most helpful if they identify the issues or the specific paragraph(s) to which the comments relate and clearly explain the reasons for the positions taken. Those who disagree with provisions of this proposed Statement are asked to describe their suggested alternatives, supported by specific reasoning. Respondents must submit comments in writing by December 8, 2008.

The Board specifically requests comments on the issue discussed below.

## **Time Horizon over Which an Entity Should Evaluate Its Ability to Continue as a Going Concern**

As discussed above, the Board decided to adopt the time horizon in IAS 1 (*at least, but not limited to, twelve months from the end of the reporting period*), instead of the time horizon considered in AU Section 341 (*not to exceed one year beyond the date of the financial statements*). The Board decided to use the time horizon in IAS 1 because it avoids the inherent problems that a bright-line time horizon would create for events or conditions occurring just beyond the one-year time horizon that are significant and most likely would have to be disclosed. It also would result in a convergent approach between U.S. generally accepted accounting principles and IFRSs.

Do you agree with the Board's decision to remove the bright-line time horizon in AU Section 341 in favor of the guidance in IAS 1? If not, why? Do you believe that this time horizon is helpful and operational? If not, why?

## Summary

### **Why Is the FASB Issuing This Proposed Statement and When Will It Be Effective?**

The objective of this proposed Statement is to (1) provide guidance on the preparation of financial statements as a going concern and on management's responsibility to evaluate a reporting entity's ability to continue as a going concern and (2) require disclosures when either financial statements are not prepared on a going concern basis or there is substantial doubt as to an entity's ability to continue as a going concern. Similar guidance currently resides in the auditing literature. The Board has decided that this guidance also belongs in the accounting literature because it is management's responsibility to assess the ongoing viability of the reporting entity.

An entity would be required to apply the requirements of this proposed Statement to interim or annual financial statements issued after ratification of the FASB Accounting Standards Codification.<sup>TM</sup>

### **What Is the Scope of This Proposed Statement?**

This proposed Statement would apply to business entities and not-for-profit entities that prepare financial statements in accordance with generally accepted accounting principles (GAAP). This proposed Statement would apply to both interim and annual financial statements.

### **How Will This Proposed Statement Change Current Practice?**

This proposed Statement would require that management of a reporting entity consider all available information about the future, which is at least, but is not limited to, 12 months from the end of the reporting period, when assessing whether the going concern assumption is appropriate. Prior to the issuance of this proposed Statement, the time horizon for assessment was limited to one year beyond the date of the financial statements.

The Board decided to use this time horizon because it avoids the inherent problems that a bright-line time horizon would create for events or conditions occurring just beyond the one-year time horizon that are significant and most likely would have to be disclosed.

### **What Is the Effect of This Proposed Statement on Convergence with International Financial Reporting Standards?**

This proposed Statement would introduce going concern guidance into U.S. GAAP and by modifying the guidance contained in U.S. auditing literature (AU Section 341) would reduce the differences between the going concern guidance in U.S. GAAP and the going concern guidance in IAS 1. For example, the proposed Statement would require management of an entity to use the time horizon in IAS 1 when assessing whether the

going concern assumption is appropriate. The proposed Statement also would (1) use the wording in IAS 1 with respect to the type of information that should be considered in making the going concern assessment (*all available information about the future*) and (2) require an entity to disclose when it does not present financial statements on a going concern basis.

**Proposed Statement of Financial Accounting Standards**

**Going Concern**

**October 9, 2008**

**CONTENTS**

	Paragraph Numbers
Objective .....	1
Standards of Financial Accounting and Reporting:	
Scope .....	2
Presentation .....	3–6
Disclosure .....	7–8
Effective Date and Transition.....	9
Appendix A: Background Information and Basis for Conclusions.....	A1–A11
Appendix B: Amendments to the FASB Accounting Standards Codification™ .....	B1–B5

## Proposed Statement of Financial Accounting Standards

### Going Concern

October 9, 2008

#### OBJECTIVE

1. The objective of this Statement is to provide guidance on the preparation of financial statements as a going concern and on management's responsibility to evaluate a reporting entity's ability to continue as a going concern. It also requires disclosures when either of the following conditions exists:

- a. Financial statements are not prepared on a going concern basis.
- b. There is substantial doubt as to an entity's ability to continue as a going concern.

<p>All paragraphs in this Statement have equal authority. Paragraphs in <b>bold</b> set out the main principles.</p>
--

#### STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING Scope

2. This Statement applies to business entities and not-for-profit entities that prepare financial statements in accordance with generally accepted accounting principles (GAAP). This Statement applies to both interim and annual financial statements.

#### Presentation

3. **When preparing financial statements, management shall assess the reporting entity's ability to continue as a going concern. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease operations or has no realistic alternative but to do so.**

4. In assessing whether the going concern assumption is appropriate, management shall take into account all available information about the future, which is at least, but is not limited to, 12 months from the end of the reporting period. The degree of

consideration depends on the facts in each case. If an entity has a history of profitable operations and ready access to financial resources, management may conclude that the going concern basis of accounting is appropriate without detailed analysis. In other cases, management may need to consider a wide range of factors relating to current and expected profitability, debt repayment schedules, and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate.

5. Management may identify information about certain conditions or events that, if considered in the aggregate, indicate there could be substantial doubt about the reporting entity's ability to continue as a going concern. The significance of such conditions and events will depend on the circumstances, and some may have significance only when viewed in conjunction with other conditions or events. The following are examples of those conditions and events:

- 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 loan or similar agreements, arrearages in dividends, denial of usual trade credit from suppliers, restructuring of debt, 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 an 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 drought, earthquake, or flood.

6. If, after considering the information in the aggregate, management believes that there is substantial doubt about the reporting entity's ability to continue as a going concern, management shall consider its plans for dealing with the adverse effects of those conditions and events and whether those plans will mitigate the adverse effects and whether those plans can be effectively implemented. Management's considerations relating to its plans may include the following:

- a. Plans to dispose of assets:

- (1) Restrictions on the disposal of assets, such as covenants limiting such transactions in loan or similar agreements or encumbrances against Assets
- (2) Apparent marketability of assets that the entity plans to sell
- (3) Possible direct or indirect effects of disposal of assets
- b. Plans to borrow money or restructure debt:
  - (1) Availability of debt financing, including existing or committed credit arrangements, such as lines of credit or arrangements for factoring receivables or sale-leaseback of assets
  - (2) Existing or committed arrangements to restructure or subordinate debt or to guarantee loans to the entity
  - (3) Possible effects on the entity's borrowing plans of existing restrictions on additional borrowing or the sufficiency of available collateral
- c. Plans to reduce or delay expenditures:
  - (1) Apparent feasibility of plans to reduce overhead or administrative expenditures, to postpone maintenance or research and development projects, or to lease rather than purchase assets
  - (2) Possible direct or indirect effects of reduced or delayed expenditures
- d. Plans to increase ownership equity:
  - (1) Apparent feasibility of plans to increase ownership equity, including existing or committed arrangements to raise additional capital
  - (2) Existing or committed arrangements to reduce current dividend requirements or to accelerate cash distributions from affiliates or other investors.

## Disclosure

**7. When management is aware, in making its assessment, of material uncertainties about events or conditions that may cast substantial doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties.** In particular, the entity shall disclose information that enables users of the financial statements to understand:

- a. Pertinent conditions and events giving rise to the assessment of substantial doubt about the entity's ability to continue as a going concern
- b. The possible effects of those conditions and events
- c. Management's evaluation of the significance of those conditions and events and any mitigating factors
- d. Possible discontinuance of operations

- e. Management's plans to mitigate the effect of the uncertainties and whether management's plans alleviate the substantial doubt about its ability to continue as a going concern
  - f. Information about the recoverability or classification of recorded asset amounts or the amounts or classification of liabilities.
8. When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.

### **EFFECTIVE DATE AND TRANSITION**

9. This Statement shall be effective for interim or annual financial statements issued after ratification of the FASB Accounting Standards Codification™ and shall be applied prospectively.

<p style="text-align: center;"><b>The provisions of this Statement need not be applied to immaterial items.</b></p>
---

## Appendix A

### BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

#### Introduction

A1. This appendix summarizes considerations that Board members deemed significant in reaching the conclusions in this proposed Statement. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

#### Background Information

A2. In conjunction with the Board's effort to simplify access to all authoritative U.S. GAAP by providing all the authoritative literature related to a particular topic in one place, the Board has undertaken projects to incorporate accounting guidance that originated as auditing standards into the body of authoritative literature issued by the FASB. In addition to this proposed Statement, these projects include FASB Statement No. 162, *The Hierarchy of Generally Accepted Accounting Principles*, and a proposed Statement on subsequent events. Including this guidance in authoritative accounting literature as well as in auditing standards further emphasizes that accounting and reporting are the primary responsibility of an entity and its management, not its auditor.

#### Scope

A3. The Board decided to develop a standard that would (a) provide guidance on the preparation of financial statements as a going concern and on management's responsibility to evaluate a reporting entity's ability to continue as a going concern and (b) require disclosures when either financial statements are not prepared on a going concern basis or there is substantial doubt as to an entity's ability to continue as a going concern. The Board also decided that, as part of this project, it would seek to develop a standard that converges with IAS 1 and IAS 10, *Events after the Reporting Period*, supplemented by disclosure requirements in AU Section 341.

A4. The Board concluded that management of a reporting entity has the responsibility to assess the reporting entity's ability to continue as a going concern. The Board further decided that all entities should be required to disclose when their financial statements are not prepared on a going concern basis and when there is substantial doubt as to an entity's ability to continue as a going concern.

A5. The Board decided that the project would not address the liquidation basis of accounting. However, the Board did decide to require an entity to disclose when an entity does not prepare financial statements on a going concern basis together with the basis under which it prepared the statements. In addition, the Board decided to require that an entity disclose the reason why it is not regarded to be a going concern.

### **Time Horizon through Which an Entity Should Evaluate Its Ability to Continue as a Going Concern**

A6. The Board decided to adopt the time horizon in IAS 1 (at least, but not limited to, 12 months from the end of the reporting period), instead of the time horizon considered in AU Section 341 (not to exceed 1 year beyond the date of the financial statements). The Board decided to use the time horizon in IAS 1 because it avoids the inherent problems that a bright-line time horizon would create for events or conditions occurring just beyond the one-year time horizon that are significant and most likely would have to be disclosed. It also would result in a convergent approach between U.S. GAAP and International Financial Reporting Standards (IFRSs).

### **Information Management Should Consider**

A7. The Board decided to conform the wording of the type of information that management should consider in its going concern assessment with IAS 1. Whereas AU Section 341 states that “the auditor’s evaluation is based on his or her knowledge of relevant conditions and events that exist at or have occurred prior to the date of the auditor’s report” (paragraph .02), IAS 1 refers to “all available information about the future” (paragraph 26). The Board thinks there is no substantial difference between the wording in IAS 1 and the wording previously included in AU Section 341. Therefore, the Board does not expect this decision to result in a change to practice.

### **Effective Date and Transition**

A8. The Board decided that this proposed Statement should be effective for interim or annual financial statements issued after ratification of the Codification and that it should be applied prospectively. The Board concluded that a prospective transition method would avoid requiring that an entity determine whether all available information about the future had been considered during past assessments of its ability to continue as a going concern.

## **Benefits and Costs**

A9. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement a new standard are borne primarily by present investors. The Board's assessment of the costs and benefits of issuing an accounting standard is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement an accounting standard or to quantify the value of improved information in financial statements.

A10. The Board decided to adopt the time horizon for assessment in IAS 1 because it avoids the inherent problems that a bright-line time horizon would create for events or conditions occurring just beyond the one-year time horizon that are significant and most likely would have to be disclosed. The Board believes that this change will provide more useful information to users of financial statements. The Board also believes that this proposed Statement provides the benefit of convergence with IFRSs.

A11. The Board does not believe that this proposed Statement will impose any significant costs on its constituents.

## Appendix B

# AMENDMENTS TO THE FASB ACCOUNTING STANDARDS CODIFICATION™

## Introduction

B1. This appendix outlines how this proposed Statement would affect the FASB Accounting Standards Codification™ (Codification). Because this proposed Statement would be effective for interim or annual financial statements issued after ratification of the Codification, this appendix outlines how the proposed Statement would affect the Codification rather than outlining how the proposed Statement would affect current accounting standards (that will be superseded once the Codification has been ratified).

B2. This proposed Statement would create a new Subtopic in Topic 205, *Presentation of Financial Statements*, to provide guidance on going concern.

## Amendments to the Codification

B3. Insert Subtopic 205-30 as follows: [Added text is underlined and deleted text is struck out.]

### Presentation > 205 Presentation of Financial Statements > 30 Going Concern

#### 205-30-05 Overview and Background

05-1 This Subtopic provides guidance on the preparation of financial statements as a going concern and on management's responsibility to evaluate a reporting entity's ability to continue as a going concern. It also requires disclosures when either of the following conditions exists:

- a. Financial statements are not prepared on a going concern basis.
- b. There is substantial doubt as to an entity's ability to continue as a going concern.

#### 205-30-15 Scope and Scope Exceptions

15-1 This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic, see Section 205-10-15.

## **205-30-45 Other Presentation Matters**

**45-1** When preparing financial statements, management shall assess the reporting entity's ability to continue as a going concern. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease operations or has no realistic alternative but to do so.

**45-2** In assessing whether the going concern assumption is appropriate, management shall take into account all available information about the future, which is at least, but is not limited to, 12 months from the end of the reporting period. The degree of consideration depends on the facts in each case. If an entity has a history of profitable operations and ready access to financial resources, management may conclude that the going concern basis of accounting is appropriate without detailed analysis. In other cases, management may need to consider a wide range of factors relating to current and expected profitability, debt repayment schedules, and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate.

**45-3** Management may identify information about certain conditions or events that, if considered in the aggregate, indicate there could be substantial doubt about the reporting entity's ability to continue as a going concern. The significance of such conditions and events will depend on the circumstances, and some may have significance only when viewed in conjunction with other conditions or events. The following are examples of those conditions and events:

- 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 loan or similar agreements, arrearages in dividends, denial of usual trade credit from suppliers, restructuring of debt, 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 an 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 drought, earthquake, or flood.

**45-4** If, after considering the information in the aggregate, management believes that there is substantial doubt about the reporting entity's ability to continue as a going concern, management shall consider its plans for dealing with the adverse effects of those conditions and events and whether those plans will mitigate the adverse effects and whether those plans can be effectively implemented. Management's considerations relating to its plans may include the following:

**a. Plans to dispose of assets:**

- (1) Restrictions on the disposal of assets, such as covenants limiting such transactions in loan or similar agreements or encumbrances against assets
- (2) Apparent marketability of assets that the entity plans to sell
- (3) Possible direct or indirect effects of disposal of assets

**b. Plans to borrow money or restructure debt:**

- (1) Availability of debt financing, including existing or committed credit arrangements, such as lines of credit or arrangements for factoring receivables or sale-leaseback of assets
- (2) Existing or committed arrangements to restructure or subordinate debt or to guarantee loans to the entity
- (3) Possible effects on the entity's borrowing plans of existing restrictions on additional borrowing or the sufficiency of available collateral

**c. Plans to reduce or delay expenditures:**

- (1) Apparent feasibility of plans to reduce overhead or administrative expenditures, to postpone maintenance or research and development projects, or to lease rather than purchase assets
- (2) Possible direct or indirect effects of reduced or delayed expenditures

**d. Plans to increase ownership equity:**

- (1) Apparent feasibility of plans to increase ownership equity, including existing or committed arrangements to raise additional capital
- (2) Existing or committed arrangements to reduce current dividend requirements or to accelerate cash distributions from affiliates or other investors.

## **205-30-50 Disclosure**

**50-1** When management is aware, in making its assessment, of material uncertainties about events or conditions that may cast substantial doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. In particular, the entity shall disclose information that enables users of the financial statements to understand:

- a. Pertinent conditions and events giving rise to the assessment of substantial doubt about the entity's ability to continue as a going concern
- b. The possible effects of those conditions and events
- c. Management's evaluation of the significance of those conditions and events and any mitigating factors
- d. Possible discontinuance of operations
- e. Management's plans to mitigate the effect of the uncertainties and whether management's plans alleviate the substantial doubt about its ability to continue as a going concern
- f. Information about the recoverability or classification of recorded asset amounts or the amounts or classification of liabilities.

**50-2** When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.

B4. Subtopic 942-505 (Financial Services—Depository and Lending > Equity) is amended as follows:

- a. Paragraph 942-505-50-1:

Noncompliance with regulatory capital requirements may, when considered with other factors, raise substantial doubt about a credit union's ability to continue as a going concern ~~for a reasonable period of time~~. See paragraph 205-30-50-1 for ~~Additional information that might be disclosed in situations in which there is substantial doubt about the entity's ability to continue as a going concern. for a reasonable period of time may include all of the following:~~

- ~~1. Pertinent conditions and events giving rise to the assessment of substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time~~
- ~~2. Possible effects of such conditions and events~~
- ~~3. Management's evaluation of the significance of those conditions and events and any mitigating factors~~
- ~~4. Possible discontinuance of operations~~
- ~~5. Management's plans (including any relevant financial information)~~
- ~~6. Information about the recoverability or classification of recorded asset amounts or the amounts or classifications of liabilities.~~

B5. Subtopic 948-10 (Financial Services—Mortgage Lending > Overall) is amended as follows:

a. Paragraph 948-10-50-4:

Further, noncompliance with minimum net worth requirements may, when considered with other factors, raise substantial doubt about an entity's ability to continue as a going concern ~~for a reasonable period of time.~~ See paragraph 205-30-50-1 for ~~Additional information that might be disclosed in these situations. may include the following:~~

- ~~a. Pertinent conditions and events giving rise to the assessment of substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time~~
- ~~b. Possible effects of such conditions and events~~
- ~~c. Management's evaluation of the significance of those conditions and events and any mitigating factors~~
- ~~d. Possible discontinuance of operations~~
- ~~e. Management's plans (including any relevant financial information)~~
- ~~f. Information about the recoverability or classification of recorded asset amounts or the amounts or classifications of liabilities.~~

## AU Section 341

### ***The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern***

(Supersedes section 340)

Source: SAS No. 59; SAS No. 64; SAS No. 77; SAS No. 96.

See section 9341 for interpretations of this section.

**Effective for audits of financial statements for periods beginning on or after January 1, 1989, unless otherwise indicated.**

**.01** This section provides guidance to the auditor in conducting an audit of financial statements in accordance with generally accepted auditing standards with respect to evaluating whether there is substantial doubt about the entity's ability to continue as a going concern.<sup>fn 1fn 2</sup> Continuation of an entity as a going concern is assumed in financial reporting in the absence of significant information to the contrary. 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.

### **The Auditor's Responsibility**

**.02** *[The following paragraph is effective for audits of fiscal years ending on or after November 15, 2007. See PCAOB Release 2007-005. For audits of fiscal years ending before November 15, 2007, click here.]* The auditor has a responsibility to evaluate whether there is substantial doubt about the 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 (hereinafter referred to as a *reasonable period of time*). The auditor's evaluation is based on his or her knowledge of relevant conditions and 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, as described in section 326, *Evidential Matter*.

**.03** The auditor should evaluate whether there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in the following manner:

- a. The auditor considers whether the results of his procedures performed in planning, gathering evidential matter relative to the various audit objectives, and completing the audit identify conditions and events that, when considered in the aggregate, indicate there could be substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. It may be necessary to obtain additional information about such conditions and events, as well as the appropriate evidential matter to support information that mitigates the auditor's doubt.
- b. If the auditor believes there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, he should (1) obtain information about management's plans that are intended to mitigate the effect of such conditions or events, and (2) assess the likelihood that such plans can be effectively implemented.
- c. After the auditor has evaluated management's plans, he concludes whether he has substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. If the auditor concludes there is substantial doubt, he should (1) consider the adequacy of disclosure about the entity's possible inability to continue as a going concern for a reasonable period of time, and (2) include an explanatory paragraph (following the opinion paragraph) in his audit report to reflect his conclusion. If the auditor concludes that substantial doubt does not exist, he should consider the need for disclosure.

**.04** The auditor is not responsible for predicting future conditions or events. The fact that the entity may cease to exist as a going concern subsequent to receiving a report from the auditor that does not refer to substantial doubt, even within one year following the date of the financial statements, does not, in itself, indicate inadequate performance by the auditor. Accordingly, the absence of reference to substantial doubt in an auditor's report should not be viewed as providing assurance as to an entity's ability to continue as a going concern.

## **Audit Procedures**

**.05** It is not necessary to design audit procedures solely to identify conditions and events that, when considered in the aggregate, indicate there could be substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. The results of auditing procedures designed and performed to achieve other audit objectives should be sufficient for that purpose. The following are examples of procedures that may identify such conditions and events:

- Analytical procedures
- Review of subsequent events
- Review of compliance with the terms of debt and loan agreements
- Reading of minutes of meetings of stockholders, board of directors, and important committees of the board
- Inquiry of an entity's legal counsel about litigation, claims, and assessments
- Confirmation with related and third parties of the details of arrangements to provide or maintain financial support

## Consideration of Conditions and Events

**.06** In performing audit procedures such as those presented in paragraph .05, the auditor may identify information about certain conditions or events that, when considered in the aggregate, indicate there could be substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. The significance of such conditions and events will depend on the circumstances, and some may have significance only when viewed in conjunction with others. The following are examples of such conditions and events:

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

## Consideration of Management's Plans

**.07** If, after considering the identified conditions and events in the aggregate, the auditor believes there is substantial doubt about the ability of the entity to continue as a going concern for a reasonable period of time, he should consider management's plans for dealing with the adverse effects of the conditions and events. The auditor should obtain information about the plans and consider whether it is likely the adverse effects will be mitigated for a reasonable period of time and that such plans can be effectively implemented. The auditor's considerations relating to management plans may include the following:

- Plans to dispose of assets
  - Restrictions on disposal of assets, such as covenants limiting such transactions in loan or similar agreements or encumbrances against assets
  - Apparent marketability of assets that management plans to sell
  - Possible direct or indirect effects of disposal of assets
- Plans to borrow money or restructure debt
  - Availability of debt financing, including existing or committed credit arrangements, such as lines of credit or arrangements for factoring receivables or sale-leaseback of assets
  - Existing or committed arrangements to restructure or subordinate debt or to guarantee loans to the entity
  - Possible effects on management's borrowing plans of existing restrictions on additional borrowing or the sufficiency of available collateral
- Plans to reduce or delay expenditures
  - Apparent feasibility of plans to reduce overhead or administrative expenditures, to postpone maintenance or research and development projects, or to lease rather than purchase assets
  - Possible direct or indirect effects of reduced or delayed expenditures

- Plans to increase ownership equity
  - Apparent feasibility of plans to increase ownership equity, including existing or committed arrangements to raise additional capital
  - Existing or committed arrangements to reduce current dividend requirements or to accelerate cash distributions from affiliates or other investors

**.08** When evaluating management's plans, the auditor should identify those elements that are particularly significant to overcoming the adverse effects of the conditions and events and should plan and perform auditing procedures to obtain evidential matter about them. For example, the auditor should consider the adequacy of support regarding the ability to obtain additional financing or the planned disposal of assets.

**.09** When prospective financial information is particularly significant to management's plans, the auditor should request management to provide that information and should consider the adequacy of support for significant assumptions underlying that information. The auditor should give particular attention to assumptions that are —

- Material to the prospective financial information.
- Especially sensitive or susceptible to change.
- Inconsistent with historical trends.

The auditor's consideration should be based on knowledge of the entity, its business, and its management and should include (a) reading of the prospective financial information and the underlying assumptions and (b) comparing prospective financial information in prior periods with actual results and comparing prospective information for the current period with results achieved to date. If the auditor becomes aware of factors, the effects of which are not reflected in such prospective financial information, he should discuss those factors with management and, if necessary, request revision of the prospective financial information.

### **Consideration of Financial Statement Effects**

**.10** When, after considering management's plans, the auditor concludes there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, the auditor should consider the possible effects on the

financial statements and the adequacy of the related disclosure. Some of the information that might be disclosed includes—

- Pertinent conditions and events giving rise to the assessment of substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time.
- The possible effects of such conditions and events.
- Management's evaluation of the significance of those conditions and events and any mitigating factors.
- Possible discontinuance of operations.
- Management's plans (including relevant prospective financial information).<sup>fn 3</sup>
- Information about the recoverability or classification of recorded asset amounts or the amounts or classification of liabilities.

.11 When, primarily because of the auditor's consideration of management's plans, he concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time is alleviated, he should consider the need for disclosure of the principal conditions and events that initially caused him to believe there was substantial doubt. The auditor's consideration of disclosure should include the possible effects of such conditions and events, and any mitigating factors, including management's plans.

### **Consideration of the Effects on the Auditor's Report**

.12 If, after considering identified conditions and events and management's plans, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains, the audit report should include an explanatory paragraph (following the opinion paragraph) to reflect that conclusion.<sup>fn 4</sup> The auditor's conclusion about the entity's ability to continue as a going concern should be expressed through the use of the phrase "substantial doubt about its (the entity's) ability to continue as a going concern" [or similar wording that includes the terms substantial doubt *and* going concern] as illustrated in paragraph .13. [As amended, effective for reports issued after December 31, 1990, by Statement on Auditing Standards No. 64.]

.13 An example follows of an explanatory paragraph (following the opinion paragraph) in the auditor's report describing an uncertainty about the entity's ability to continue as a going concern for a reasonable period of time.<sup>fn 5</sup>

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency that raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note X. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

[As amended, effective for reports issued after December 31, 1990, by Statement on Auditing Standards No. 64.]

**.14** If the auditor concludes that the entity's disclosures with respect to the entity's ability to continue as a going concern for a reasonable period of time are inadequate, a departure from generally accepted accounting principles exists. This may result in either a qualified (except for) or an adverse opinion. Reporting guidance for such situations is provided in section 508, *Reports on Audited Financial Statements*.

**.15** Substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time that arose in the current period does not imply that a basis for such doubt existed in the prior period and, therefore, should not affect the auditor's report on the financial statements of the prior period that are presented on a comparative basis. When financial statements of one or more prior periods are presented on a comparative basis with financial statements of the current period, reporting guidance is provided in section 508.

**.16** If substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time existed at the date of prior period financial statements that are presented on a comparative basis, and that doubt has been removed in the current period, the explanatory paragraph included in the auditor's report (following the opinion paragraph) on the financial statements of the prior period should not be repeated.

## **Documentation**

**.17** As stated in paragraph .03 of this section, the auditor considers whether the results of the auditing procedures performed in planning, gathering evidential matter relative to the various audit objectives, and completing the audit identify conditions and events that, when considered in the aggregate, indicate there could be substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. If, after considering the identified conditions and events in the aggregate, the auditor believes there is substantial doubt about the ability of the entity to continue as a going

concern for a reasonable period of time, he or she follows the guidance in paragraphs .07 through .16. In connection with that guidance, the auditor should document all of the following:

- a. The conditions or events that led him or her to believe that there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time.
- b. The elements of management's plans that the auditor considered to be particularly significant to overcoming the adverse effects of the conditions or events.
- c. The auditing procedures performed and evidence obtained to evaluate the significant elements of management's plans.
- d. The auditor's conclusion as to whether substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains or is alleviated. If substantial doubt remains, the auditor also should document the possible effects of the conditions or events on the financial statements and the adequacy of the related disclosures. If substantial doubt is alleviated, the auditor also should document the conclusion as to the need for disclosure of the principal conditions and events that initially caused him or her to believe there was substantial doubt.
- e. The auditor's conclusion as to whether he or she should include an explanatory paragraph in the audit report. If disclosures with respect to an entity's ability to continue as a going concern are inadequate, the auditor also should document the conclusion as to whether to express a qualified or adverse opinion for the resultant departure from generally accepted accounting principles.

[Paragraph added, effective for audits of financial statements for periods beginning on or after May 15, 2002, by Statement on Auditing Standards No. 96.]

## **Effective Date**

**.18** This section is effective for audits of financial statements for periods beginning on or after January 1, 1989. Early application of the provisions of this section is permissible. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 96, January 2002.]

---

**Footnotes (AU Section 341 — The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern):**

<sup>fn 1</sup> This section does not apply to an audit of financial statements based on the assumption of liquidation (for example, when [a] an entity is in the process of liquidation, [b] the owners have decided to commence dissolution or liquidation, or [c] legal proceedings, including bankruptcy, have reached a point at which dissolution or liquidation is probable). See Auditing Interpretation, "Reporting on Financial Statements Prepared on a Liquidation Basis of Accounting" (section 9508.33-.38).

<sup>fn 2</sup> The guidance provided in this section applies to audits of financial statements prepared either in accordance with generally accepted accounting principles or in accordance with a comprehensive basis of accounting other than generally accepted accounting principles. References in this section to generally accepted accounting principles are intended to include a comprehensive basis of accounting other than generally accepted accounting principles (excluding liquidation basis).

<sup>fn 3</sup> It is not intended that such prospective financial information constitute prospective financial statements meeting the minimum presentation guidelines set forth in AT section 301, *Financial Forecasts and Projections*, nor that the inclusion of such information require any consideration beyond that normally required by generally accepted auditing standards. [Footnote revised, January 2001, to reflect conforming changes necessary due to the issuance of Statement on Standards for Attestation Engagements No. 10.]

<sup>fn 4</sup> The inclusion of an explanatory paragraph (following the opinion paragraph) in the auditor's report contemplated by this section should serve adequately to inform the users of the financial statements. Nothing in this section, however, is intended to preclude an auditor from declining to express an opinion in cases involving uncertainties. If he disclaims an opinion, the uncertainties and their possible effects on the financial statements should be disclosed in an appropriate manner (see paragraph .10), and the auditor's report should give all the substantive reasons for his disclaimer of opinion (see section 508, *Reports on Audited Financial Statements*).

<sup>fn 5</sup> In a going-concern explanatory paragraph, the auditor should not use conditional language in expressing a conclusion concerning the existence of substantial doubt about the entity's ability to continue as a going concern. Examples of inappropriate wording in the explanatory paragraph would be, "If the Company continues to suffer recurring losses from operations and continues to have a net capital deficiency, there may be substantial doubt about its ability to continue as a going concern" or "The Company has been unable to renegotiate its expiring credit agreements. Unless the Company is able to obtain financial support, there is substantial doubt about its ability to continue as a going concern." [Footnote added, effective for reports issued after December 15, 1995, by Statement on Auditing Standards No. 77.]

*International Standard on Auditing*

---

**ISA 570, Going Concern**

International Auditing and Assurance Standards Board  
International Federation of Accountants  
545 Fifth Avenue, 14th Floor New York, New York 10017 USA

This International Standard on Auditing (ISA) 570, “Going Concern” was prepared by the International Auditing and Assurance Standards Board (IAASB), an independent standard-setting body within the International Federation of Accountants (IFAC). The objective of the IAASB is to serve the public interest by setting high quality auditing and assurance standards and by facilitating the convergence of international and national standards, thereby enhancing the quality and uniformity of practice throughout the world and strengthening public confidence in the global auditing and assurance profession.

This publication may be downloaded free of charge from the IFAC website: <http://www.ifac.org>. The approved text is published in the English language.

The mission of IFAC is to serve the public interest, strengthen the worldwide accountancy profession and contribute to the development of strong international economies by establishing and promoting adherence to high quality professional standards, furthering the international convergence of such standards and speaking out on public interest issues where the profession’s expertise is most relevant.

Copyright © March 2009 by the International Federation of Accountants (IFAC). All rights reserved. Permission is granted to make copies of this work provided that such copies are for use in academic classrooms or for personal use and are not sold or disseminated and provided that each copy bears the following credit line: *“Copyright © March 2009 by the International Federation of Accountants (IFAC). All rights reserved. Used with permission of IFAC. Contact [permissions@ifac.org](mailto:permissions@ifac.org) for permission to reproduce, store or transmit this document.”* Otherwise, written permission from IFAC is required to reproduce, store or transmit, or to make other similar uses of, this document, except as permitted by law. Contact [permissions@ifac.org](mailto:permissions@ifac.org).

ISBN: 978-1-934779-24-8

**INTERNATIONAL STANDARD ON AUDITING 570  
GOING CONCERN**

(Effective for audits of financial statements for periods beginning on or after December  
15, 2009)

**CONTENTS**

	Paragraph
<b>Introduction</b>	
Scope of this ISA .....	1
Going Concern Assumption .....	2
Responsibility for Assessment of the Entity's Ability to Continue as a Going Concern.....	3-7
Effective Date .....	8
<b>Objectives</b> .....	9
<b>Requirements</b>	
Risk Assessment Procedures and Related Activities .....	10-11
Evaluating Management's Assessment .....	12-14
Period beyond Management's Assessment .....	15
Additional Audit Procedures When Events or Conditions Are Identified.....	16
Audit Conclusions and Reporting .....	17
Use of Going Concern Assumption Appropriate but a Material Uncertainty Exists .....	18-20
Use of Going Concern Assumption Inappropriate .....	21
Management Unwilling to Make or Extend Its Assessment .....	22
Communication with Those Charged with Governance .....	23
Significant Delay in the Approval of Financial Statements .....	24
<b>Application and Other Explanatory Material</b>	
Going Concern Assumption .....	A1
Risk Assessment Procedures and Related Activities .....	A2-A6
Evaluating Management's Assessment .....	A7-A12
Period beyond Management's Assessment .....	A13-A14
Additional Audit Procedures When Events or Conditions Are Identified.....	A15-A18

Audit Conclusions and Reporting .....A19  
Use of Going Concern Assumption Appropriate but a Material  
    Uncertainty Exists ..... A20-A24  
Use of Going Concern Assumption Inappropriate ..... A25-A26  
Management Unwilling to Make or Extend Its Assessment ..... A27

International Standard on Auditing (ISA) 570, “Going Concern” should be read in conjunction with ISA 200, “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing.”

## **Introduction**

### **Scope of this ISA**

1. This International Standard on Auditing (ISA) deals with the auditor's responsibilities in the audit of financial statements relating to management's use of the going concern assumption in the preparation of the financial statements.

### **Going Concern Assumption**

2. Under the going concern assumption, an entity is viewed as continuing in business for the foreseeable future. General purpose financial statements are prepared on a going concern basis, unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so. Special purpose financial statements may or may not be prepared in accordance with a financial reporting framework for which the going concern basis is relevant (for example, the going concern basis is not relevant for some financial statements prepared on a tax basis in particular jurisdictions). When the use of the going concern assumption is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business. (Ref: Para. A1)

### **Responsibility for Assessment of the Entity's Ability to Continue as a Going Concern**

3. Some financial reporting frameworks contain an explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern, and standards regarding matters to be considered and disclosures to be made in connection with going concern. For example, International Accounting Standard (IAS) 1 requires management to make an assessment of an entity's ability to continue as a going concern.<sup>1</sup> The detailed requirements regarding management's responsibility to assess the entity's ability to continue as a going concern and related financial statement disclosures may also be set out in law or regulation.
4. In other financial reporting frameworks, there may be no explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern. Nevertheless, since the going concern assumption is a

---

<sup>1</sup> IAS 1, "Presentation of Financial Statements" as at 1 January 2009, paragraphs 25-26.

fundamental principle in the preparation of financial statements as discussed in paragraph 2, the preparation of the financial statements requires management to assess the entity's ability to continue as a going concern even if the financial reporting framework does not include an explicit requirement to do so.

5. Management's assessment of the entity's ability to continue as a going concern involves making a judgment, at a particular point in time, about inherently uncertain future outcomes of events or conditions. The following factors are relevant to that judgment:

- The degree of uncertainty associated with the outcome of an event or condition increases significantly the further into the future an event or condition or the outcome occurs. For that reason, most financial reporting frameworks that require an explicit management assessment specify the period for which management is required to take into account all available information.
- The size and complexity of the entity, the nature and condition of its business and the degree to which it is affected by external factors affect the judgment regarding the outcome of events or conditions.
- Any judgment about the future is based on information available at the time at which the judgment is made. Subsequent events may result in outcomes that are inconsistent with judgments that were reasonable at the time they were made.

#### *Responsibilities of the Auditor*

6. The auditor's responsibility is to obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation and presentation of the financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern. This responsibility exists even if the financial reporting framework used in the preparation of the financial statements does not include an explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern.

7. However, as described in ISA 200,<sup>2</sup> the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for future events or conditions that may cause an entity to cease to continue as a going concern. The auditor cannot predict such future events or conditions. Accordingly, the absence of any reference to going concern uncertainty in an auditor's report cannot be viewed as a guarantee as to the entity's ability to continue as a going concern.

#### Effective Date

8. This ISA is effective for audits of financial statements for periods beginning on or after December 15, 2009.

#### Objectives

9. The objectives of the auditor are:
  - (a) To obtain sufficient appropriate audit evidence regarding the appropriateness of management's use of the going concern assumption in the preparation of the financial statements;
  - (b) To conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern; and
  - (c) To determine the implications for the auditor's report.

#### Requirements

#### Risk Assessment Procedures and Related Activities

10. When performing risk assessment procedures as required by ISA 315,<sup>3</sup> the auditor shall consider whether there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. In so

---

<sup>2</sup> ISA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing."

<sup>3</sup> ISA 315, "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment," paragraph 5.

doing, the auditor shall determine whether management has already performed a preliminary assessment of the entity's ability to continue as a going concern, and: (Ref: Para. A2-A5)

- (a) If such an assessment has been performed, the auditor shall discuss the assessment with management and determine whether management has identified events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern and, if so, management's plans to address them; or
  - (b) If such an assessment has not yet been performed, the auditor shall discuss with management the basis for the intended use of the going concern assumption, and inquire of management whether events or conditions exist that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern.
11. The auditor shall remain alert throughout the audit for audit evidence of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. (Ref: Para. A6)

### **Evaluating Management's Assessment**

12. The auditor shall evaluate management's assessment of the entity's ability to continue as a going concern. (Ref: Para. A7-A9; A11-A12)
13. In evaluating management's assessment of the entity's ability to continue as a going concern, the auditor shall cover the same period as that used by management to make its assessment as required by the applicable financial reporting framework, or by law or regulation if it specifies a longer period. If management's assessment of the entity's ability to continue as a going concern covers less than twelve months from the date of the financial statements as defined in ISA 560,<sup>4</sup> the auditor shall request management to extend its assessment period to at least twelve months from that date. (Ref: Para. A10-A12)

---

<sup>4</sup> ISA 560, "Subsequent Events," paragraph 5(a)

14. In evaluating management's assessment, the auditor shall consider whether management's assessment includes all relevant information of which the auditor is aware as a result of the audit.

#### **Period beyond Management's Assessment**

15. The auditor shall inquire of management as to its knowledge of events or conditions beyond the period of management's assessment that may cast significant doubt on the entity's ability to continue as a going concern. (Ref: Para. A13-A14)

#### **Additional Audit Procedures When Events or Conditions Are Identified**

16. If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists through performing additional audit procedures, including consideration of mitigating factors. These procedures shall include: (Ref: Para. A15)
  - (a) Where management has not yet performed an assessment of the entity's ability to continue as a going concern, requesting management to make its assessment.
  - (b) Evaluating management's plans for future actions in relation to its going concern assessment, whether the outcome of these plans is likely to improve the situation and whether management's plans are feasible in the circumstances. (Ref: Para. A16)
  - (c) Where the entity has prepared a cash flow forecast, and analysis of the forecast is a significant factor in considering the future outcome of events or conditions in the evaluation of management's plans for future action: (Ref: Para. A17-A18)
    - (i) Evaluating the reliability of the underlying data generated to prepare the forecast; and
    - (ii) Determining whether there is adequate support for the assumptions underlying the forecast.
  - (d) Considering whether any additional facts or information have become available since the date on which management made its assessment.

- (e) Requesting written representations from management and, where appropriate, those charged with governance, regarding their plans for future action and the feasibility of these plans.

### **Audit Conclusions and Reporting**

- 17. Based on the audit evidence obtained, the auditor shall conclude whether, in the auditor's judgment, a material uncertainty exists related to events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern. A material uncertainty exists when the magnitude of its potential impact and likelihood of occurrence is such that, in the auditor's judgment, appropriate disclosure of the nature and implications of the uncertainty is necessary for: (Ref: Para. A19)
  - (a) In the case of a fair presentation financial reporting framework, the fair presentation of the financial statements, or
  - (b) In the case of a compliance framework, the financial statements not to be misleading.

### **Use of Going Concern Assumption Appropriate but a Material Uncertainty Exists**

- 18. If the auditor concludes that the use of the going concern assumption is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements: (Ref: Para.A20)
  - (a) Adequately describe the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and
  - (b) Disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business.
- 19. If adequate disclosure is made in the financial statements, the auditor shall express an unmodified opinion and include an Emphasis of Matter paragraph in the auditor's report to: (Ref: Para. A21-A22)

- (a) Highlight the existence of a material uncertainty relating to the event or condition that may cast significant doubt on the entity's ability to continue as a going concern; and to
  - (b) Draw attention to the note in the financial statements that discloses the matters set out in paragraph 18. (See ISA 706.<sup>5</sup>)
20. If adequate disclosure is not made in the financial statements, the auditor shall express a qualified opinion or adverse opinion, as appropriate, in accordance with ISA 705.<sup>6</sup>) The auditor shall state in the auditor's report that there is a material uncertainty that may cast significant doubt about the entity's ability to continue as a going concern. (Ref: Para. A23-A24)

#### Use of Going Concern Assumption Inappropriate

21. If the financial statements have been prepared on a going concern basis but, in the auditor's judgment, management's use of the going concern assumption in the financial statements is inappropriate, the auditor shall express an adverse opinion. (Ref: Para. A25-A26)

#### **Management Unwilling to Make or Extend Its Assessment**

22. If management is unwilling to make or extend its assessment when requested to do so by the auditor, the auditor shall consider the implications for the auditor's report. (Ref: Para. A27)

#### **Communication with Those Charged with Governance**

23. Unless all those charged with governance are involved in managing the entity<sup>7</sup>, the auditor shall communicate with those charged with governance events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern. Such communication with those charged with governance shall include the following:

---

<sup>5</sup> ISA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report."

<sup>6</sup> ISA 705, "Modifications to the Opinion in the Independent Auditor's Report."

<sup>7</sup> ISA 260, "Communication with Those Charged with Governance," paragraph 13.

- (a) Whether the events or conditions constitute a material uncertainty;
- (b) Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements; and
- (c) The adequacy of related disclosures in the financial statements.

### **Significant Delay in the Approval of Financial Statements**

24. If there is significant delay in the approval of the financial statements by management or those charged with governance after the date of the financial statements, the auditor shall inquire as to the reasons for the delay. If the auditor believes that the delay could be related to events or conditions relating to the going concern assessment, the auditor shall perform those additional audit procedures necessary, as described in paragraph 16, as well as consider the effect on the auditor's conclusion regarding the existence of a material uncertainty, as described in paragraph 17.

\*\*\*

### **Application and Other Explanatory Material**

#### **Going Concern Assumption (Ref: Para. 2)**

##### *Considerations Specific to Public Sector Entities*

- A1. Management's use of the going concern assumption is also relevant to public sector entities. For example, International Public Sector Accounting Standard (IPSAS) 1 addresses the issue of the ability of public sector entities to continue as going concerns.<sup>8</sup> Going concern risks may arise, but are not limited to, situations where public sector entities operate on a for-profit basis, where government support may be reduced or withdrawn, or in the case of privatization. Events or conditions that may cast significant doubt on an entity's ability to continue as a going concern in the public sector may include situations where the public sector entity lacks funding for its continued existence or when policy decisions are made that affect the services provided by the public sector entity.

---

<sup>8</sup> IPSAS 1, "Presentation of Financial Statements" as at 1 January 2007, paragraphs 38-41

## **Risk Assessment Procedures and Related Activities**

*Events or Conditions That May Cast Doubt about Going Concern Assumption* (Ref: Para. 10)

A2. The following are examples of events or conditions that, individually or collectively, may cast significant doubt about the going concern assumption. This listing is not all-inclusive nor does the existence of one or more of the items always signify that a material uncertainty exists.

### Financial

- Net liability or net current liability position.
- Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets.
- Indications of withdrawal of financial support by creditors.
- Negative operating cash flows indicated by historical or prospective financial statements.
- Adverse key financial ratios.
- Substantial operating losses or significant deterioration in the value of assets used to generate cash flows.
- Arrears or discontinuance of dividends.
- Inability to pay creditors on due dates.
- Inability to comply with the terms of loan agreements.
- Change from credit to cash-on-delivery transactions with suppliers.
- Inability to obtain financing for essential new product development or other essential investments.

### Operating

- Management intentions to liquidate the entity or to cease operations.

- Loss of key management without replacement.
- Loss of a major market, key customer(s), franchise, license, or principal supplier(s).
- Labor difficulties.
- Shortages of important supplies.
- Emergence of a highly successful competitor.

Other

- Non-compliance with capital or other statutory requirements.
- Pending legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy.
- Changes in law or regulation or government policy expected to adversely affect the entity.
- Uninsured or underinsured catastrophes when they occur.

The significance of such events or conditions often can be mitigated by other factors. For example, the effect of an entity being unable to make its normal debt repayments may be counter-balanced by management's plans to maintain adequate cash flows by alternative means, such as by disposing of assets, rescheduling loan repayments, or obtaining additional capital. Similarly, the loss of a principal supplier may be mitigated by the availability of a suitable alternative source of supply.

- A3. The risk assessment procedures required by paragraph 10 help the auditor to determine whether management's use of the going concern assumption is likely to be an important issue and its impact on planning the audit. These procedures also allow for more timely discussions with management, including a discussion of management's plans and resolution of any identified going concern issues.

### Considerations Specific to Smaller Entities

- A4. The size of an entity may affect its ability to withstand adverse conditions. Small entities may be able to respond quickly to exploit opportunities, but may lack reserves to sustain operations.
- A5. Conditions of particular relevance to small entities include the risk that banks and other lenders may cease to support the entity, as well as the possible loss of a principal supplier, major customer, key employee, or the right to operate under a license, franchise or other legal agreement.

### *Remaining Alert throughout the Audit for Audit Evidence about Events or Conditions* (Ref: Para. 11)

- A6. ISA 315 requires the auditor to revise the auditor's risk assessment and modify the further planned audit procedures accordingly when additional audit evidence is obtained during the course of the audit that affects the auditor's assessment of risk.<sup>9</sup> If events or conditions that may cast significant doubt on the entity's ability to continue as a going concern are identified after the auditor's risk assessments are made, in addition to performing the procedures in paragraph 16, the auditor's assessment of the risks of material misstatement may need to be revised. The existence of such events or conditions may also affect the nature, timing and extent of the auditor's further procedures in response to the assessed risks. ISA 330<sup>10</sup> establishes requirements and provides guidance on this issue.

### **Evaluating Management's Assessment**

### *Management's Assessment and Supporting Analysis and the Auditor's Evaluation* (Ref: Para. 12)

- A7. Management's assessment of the entity's ability to continue as a going concern is a key part of the auditor's consideration of management's use of the going concern assumption.
- A8. It is not the auditor's responsibility to rectify the lack of analysis by management. In some circumstances, however, the lack of detailed analysis by management to

---

<sup>9</sup> ISA 315, paragraph 31.

<sup>10</sup> ISA 330, "The Auditor's Responses to Assessed Risks."

support its assessment may not prevent the auditor from concluding whether management's use of the going concern assumption is appropriate in the circumstances. For example, when there is a history of profitable operations and a ready access to financial resources, management may make its assessment without detailed analysis. In this case, the auditor's evaluation of the appropriateness of management's assessment may be made without performing detailed evaluation procedures if the auditor's other audit procedures are sufficient to enable the auditor to conclude whether management's use of the going concern assumption in the preparation of the financial statements is appropriate in the circumstances.

- A9. In other circumstances, evaluating management's assessment of the entity's ability to continue as a going concern, as required by paragraph 12, may include an evaluation of the process management followed to make its assessment, the assumptions on which the assessment is based and management's plans for future action and whether management's plans are feasible in the circumstances.

*The Period of Management's Assessment* (Ref: Para. 13)

- A10. Most financial reporting frameworks requiring an explicit management assessment specify the period for which management is required to take into account all available information.<sup>11</sup>

*Considerations Specific to Smaller Entities* (Ref: Para. 12-13)

- A11. In many cases, the management of smaller entities may not have prepared a detailed assessment of the entity's ability to continue as a going concern, but instead may rely on in-depth knowledge of the business and anticipated future prospects. Nevertheless, in accordance with the requirements of this ISA, the auditor needs to evaluate management's assessment of the entity's ability to continue as a going concern. For smaller entities, it may be appropriate to discuss the medium and long-term financing of the entity with management, provided that management's contentions can be corroborated by sufficient documentary evidence and are not inconsistent with the auditor's understanding of the entity. Therefore, the requirement in paragraph 13 for the auditor to request management to extend its assessment may, for example, be satisfied by discussion, inquiry and inspection of supporting documentation, for example,

---

<sup>11</sup> For example, IAS 1 defines this as a period that should be at least, but is not limited to, twelve months from the balance sheet date.

orders received for future supply, evaluated as to their feasibility or otherwise substantiated.

- A12. Continued support by owner-managers is often important to smaller entities' ability to continue as a going concern. Where a small entity is largely financed by a loan from the owner-manager, it may be important that these funds are not withdrawn. For example, the continuance of a small entity in financial difficulty may be dependent on the owner-manager subordinating a loan to the entity in favor of banks or other creditors, or the owner manager supporting a loan for the entity by providing a guarantee with his or her personal assets as collateral. In such circumstances the auditor may obtain appropriate documentary evidence of the subordination of the owner-manager's loan or of the guarantee. Where an entity is dependent on additional support from the owner-manager, the auditor may evaluate the owner-manager's ability to meet the obligation under the support arrangement. In addition, the auditor may request written confirmation of the terms and conditions attaching to such support and the owner-manager's intention or understanding.

**Period beyond Management's Assessment (Ref: Para. 15)**

- A13. As required by paragraph 11, the auditor remains alert to the possibility that there may be known events, scheduled or otherwise, or conditions that will occur beyond the period of assessment used by management that may bring into question the appropriateness of management's use of the going concern assumption in preparing the financial statements. Since the degree of uncertainty associated with the outcome of an event or condition increases as the event or condition is further into the future, in considering events or conditions further in the future, the indications of going concern issues need to be significant before the auditor needs to consider taking further action. If such events or conditions are identified, the auditor may need to request management to evaluate the potential significance of the event or condition on its assessment of the entity's ability to continue as a going concern. In these circumstances the procedures in paragraph 16 apply.
- A14. Other than inquiry of management, the auditor does not have a responsibility to perform any other audit procedures to identify events or conditions that may cast significant doubt on the entity's ability to continue as a going concern beyond the period assessed by management, which, as discussed in paragraph 13, would be at least twelve months from the date of the financial statements.

**Additional Audit Procedures When Events or Conditions Are Identified** (Ref: Para. 16)

A15. Audit procedures that are relevant to the requirement in paragraph 16 may include the following:

- Analyzing and discussing cash flow, profit and other relevant forecasts with management.
- Analyzing and discussing the entity's latest available interim financial statements.
- Reading the terms of debentures and loan agreements and determining whether any have been breached.
- Reading minutes of the meetings of shareholders, those charged with governance and relevant committees for reference to financing difficulties.
- Inquiring of the entity's legal counsel regarding the existence of litigation and claims and the reasonableness of management's assessments of their outcome and the estimate of their financial implications.
- Confirming the existence, legality and enforceability of arrangements to provide or maintain financial support with related and third parties and assessing the financial ability of such parties to provide additional funds.
- Evaluating the entity's plans to deal with unfilled customer orders.
- Performing audit procedures regarding subsequent events to identify those that either mitigate or otherwise affect the entity's ability to continue as a going concern.
- Confirming the existence, terms and adequacy of borrowing facilities.
- Obtaining and reviewing reports of regulatory actions.
- Determining the adequacy of support for any planned disposals of assets.

*Evaluating Management's Plans for Future Actions* (Ref: Para. 16(b))

A16. Evaluating management's plans for future actions may include inquiries of management as to its plans for future action, including, for example, its plans to

liquidate assets, borrow money or restructure debt, reduce or delay expenditures, or increase capital.

*The Period of Management's Assessment* (Ref: Para. 16(c))

A17. In addition to the procedures required in paragraph 16(c), the auditor may compare:

- The prospective financial information for recent prior periods with historical results; and
- The prospective financial information for the current period with results achieved to date.

A18. Where management's assumptions include continued support by third parties, whether through the subordination of loans, commitments to maintain or provide additional funding, or guarantees, and such support is important to an entity's ability to continue as a going concern, the auditor may need to consider requesting written confirmation (including of terms and conditions) from those third parties and to obtain evidence of their ability to provide such support.

**Audit Conclusions and Reporting** (Ref: Para. 17)

A19. The phrase "material uncertainty" is used in IAS 1 in discussing the uncertainties related to events or conditions which may cast significant doubt on the entity's ability to continue as a going concern that should be disclosed in the financial statements. In some other financial reporting frameworks the phrase "significant uncertainty" is used in similar circumstances.

**Use of Going Concern Assumption Appropriate but a Material Uncertainty Exists**

*Adequacy of Disclosure of Material Uncertainty* (Ref: Para. 18)

A20. The determination of the adequacy of the financial statement disclosure may involve determining whether the information explicitly draws the reader's attention to the possibility that the entity may be unable to continue realizing its assets and discharging its liabilities in the normal course of business.

*Audit Reporting When Disclosure of Material Uncertainty Is Adequate* (Ref: Para. 19)

- A21. The following is an illustration of an Emphasis of Matter paragraph when the auditor is satisfied as to the adequacy of the note disclosure:

*Emphasis of Matter*

Without qualifying our opinion, we draw attention to Note X in the financial statements which indicates that the Company incurred a net loss of ZZZ during the year ended December 31, 20X1 and, as of that date, the Company's current liabilities exceeded its total assets by YYY. These conditions, along with other matters as set forth in Note X, indicate the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern.

- A22. In situations involving multiple material uncertainties that are significant to the financial statements as a whole, the auditor may consider it appropriate in extremely rare cases to express a disclaimer of opinion instead of adding an Emphasis of Matter paragraph. ISA 705 provides guidance on this issue.

*Audit Reporting When Disclosure of Material Uncertainty Is Inadequate (Ref: Para. 20)*

- A23. The following is an illustration of the relevant paragraphs when a qualified opinion is to be expressed:

*Basis for Qualified Opinion*

The Company's financing arrangements expire and amounts outstanding are payable on March 19, 20X1. The Company has been unable to re-negotiate or obtain replacement financing. This situation indicates the existence of a material uncertainty that may cast significant doubt on the Company's ability to continue as a going concern and therefore the Company may be unable to realize its assets and discharge its liabilities in the normal course of business. The financial statements (and notes thereto) do not fully disclose this fact.

*Qualified Opinion*

In our opinion, except for the incomplete disclosure of the information referred to in the Basis for Qualified Opinion paragraph, the financial statements present fairly, in all material respects (or "give a true and fair view of") the financial position of the Company at December 31, 20X0 and of its financial performance and its cash flows for the year then ended in accordance with ...

- A24. The following is an illustration of the relevant paragraphs when an adverse opinion is to be expressed:

*Basis for Adverse Opinion*

The Company's financing arrangements expired and the amount outstanding was payable on December 31, 20X0. The Company has been unable to re-negotiate or obtain replacement financing and is considering filing for bankruptcy. These events indicate a material uncertainty that may cast significant doubt on the Company's ability to continue as a going concern and therefore it may be unable to realize its assets and discharge its liabilities in the normal course of business. The financial statements (and notes thereto) do not disclose this fact.

*Adverse Opinion*

In our opinion, because of the omission of the information mentioned in the Basis for Adverse Opinion paragraph, the financial statements do not present fairly (or "give a true and fair view of") the financial position of the Company as at December 31, 20X0, and of its financial performance and its cash flows for the year then ended in accordance with...

Use of Going Concern Assumption Inappropriate (Ref: Para. 21)

- A25. If the financial statements have been prepared on a going concern basis but, in the auditor's judgment, management's use of the going concern assumption in the financial statements is inappropriate, the requirement of paragraph 21 for the auditor to express an adverse opinion applies regardless of whether or not the financial statements include disclosure of the inappropriateness of management's use of the going concern assumption.
- A26. If the entity's management is required, or elects, to prepare financial statements when the use of the going concern assumption is not appropriate in the circumstances, the financial statements are prepared on an alternative basis (for example, liquidation basis). The auditor may be able to perform an audit of those financial statements provided that the auditor determines that the alternative basis is an acceptable financial reporting framework in the circumstances. The auditor may be able to express an unmodified opinion on those financial statements, provided there is adequate disclosure therein but may consider it appropriate or necessary to include an Emphasis of Matter paragraph in the

auditor's report to draw the user's attention to that alternative basis and the reasons for its use.

**Management Unwilling to Make or Extend Its Assessment** (Ref: Para. 22)

A27. In certain circumstances, the auditor may believe it necessary to request management to make or extend its assessment. If management is unwilling to do so, a qualified opinion or a disclaimer of opinion in the auditor's report may be appropriate, because it may not be possible for the auditor to obtain sufficient appropriate audit evidence regarding the use of the going concern assumption in the preparation of the financial statements, such as audit evidence regarding the existence of plans management has put in place or the existence of other mitigating factors.