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Going Concern: FASB Issues New Standard on Reporting Adverse Conditions and Events

The Financial Accounting Standards Board (FASB) has released a new accounting standard that provides much-needed guidance on management's responsibility in evaluating and disclosing adverse conditions or events that raise substantial doubt about a company's ability to continue as a "going concern." The guidance, published in Accounting Standards Update (ASU) 2014-15, *Presentation of Financial Statements — Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*, applies to all companies that prepare their financial statements in accordance with US Generally Accepted Accounting Principles (GAAP).

The changes in ASU 2014-15 are effective for the annual financial statement period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted.

The Need for Guidance

Financial statements that adhere with GAAP generally are prepared under the going-concern basis of accounting. The going-concern basis presumes that the organization will continue to operate as a going concern. If and when an organization's liquidation becomes imminent, its financial statements must be prepared under the liquidation basis of accounting. However, an organization could experience certain adverse conditions or events that raise substantial doubt about its ability to continue before liquidation is clearly imminent, and financial statements should still be prepared on the going-concern basis for this period.

GAAP has lacked guidance on management's responsibility to evaluate or disclose adverse conditions or events. Although organizations regularly provided footnote disclosures about such circumstances, different organizations have taken different approaches to determining whether substantial doubt exists. The result has been variations in whether, when, and how organizations disclose the relevant conditions and events.

Non-GAAP Standards

Under US auditing standards and federal securities law, auditors (not management) must evaluate whether substantial doubt exists about an organization'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. US auditing standards also require auditors to assess the potential financial statement effects, including footnote disclosures on uncertainties about an organization's ability to continue for a reasonable period of time.

Additionally, the US Securities and Exchange Commission has provided guidance on the disclosures an organization must make when its auditor's report includes an explanatory paragraph that indicates substantial doubt about the organization's ability to continue for a reasonable period of time.

International Financial Reporting Standards (IFRS) require disclosures when management is aware of material uncertainties related to events and conditions that might cast significant doubt on the organization's ability to continue as a going concern. The IFRS assessment period runs at least one year from the financial statement date, with no upper time limit.

Identifying "Substantial Doubt"

ASU 2014-15 is FASB's response to stakeholders' concerns about the lack of GAAP guidance as to what qualifies as substantial doubt. The guidance incorporates and expands on certain principles in the existing US auditing standards. For that reason, the required disclosures might not substantially change the information already being disclosed in many audited financial statements.

The new GAAP definition of substantial doubt presents a high threshold before mandatory disclosures are triggered. It requires a focus on significant uncertainties about an organization's ability to continue, as opposed to a broader consideration of all uncertainties and risk factors.

Under the new standard, management must evaluate whether conditions or events raise substantial doubt about the organization's ability to continue as a going concern for a period of one year from the date the financial statements are issued or, when applicable, available to be issued. Substantial doubt exists when conditions or events, considered in the aggregate, indicate that it's probable — or likely — that the organization will not be able to meet its obligations as they become due within one year. Note that the one-year limit is consistent with US auditing standards, but not IFRS.

The evaluation should examine both qualitative and quantitative information about relevant conditions and events. This information includes the organization's current financial condition, conditional and unconditional obligations due or anticipated within one year, and the funds necessary to maintain operations.

Mandatory Footnote Disclosures

If management identifies conditions or events that raise substantial doubt, it must consider whether its plans for mitigating those conditions or events will be effective. The mitigating effect of the plans should be considered only to the extent that 1) it is probable that the plans will be effectively implemented, and, if so, 2) it is probable that the plans will mitigate the conditions or events at issue.

Should management's plans alleviate the substantial doubt, the organization is nonetheless required to make footnote disclosures that allow users of the financial statements to understand:

- Principal conditions or events that raise substantial doubt, before consideration of management's plans,
- Management's evaluation of the significance of those conditions or events in relation to the organization's ability to meet its obligations, and
- Management's plans that alleviated substantial doubt.

And if management's plans do not alleviate the substantial doubt, the organization must indicate in the footnotes that substantial doubt exists about the organization's ability to continue.

Under such circumstances, management also must disclose information that allows users to understand:

- Principal conditions or events that raise substantial doubt,
- Management's evaluation of the significance of those conditions or events in relation to the organization's ability to meet its obligations, and
- Management's plans that are intended to mitigate the conditions or events that raise substantial doubt.

The organization must continue to make the appropriate going concern disclosures in subsequent reporting periods in which conditions or events continue to raise substantial doubt. Disclosures should become more extensive as additional information becomes available to the organization about relevant conditions or events and management's plans.

What Now?

Early application of the new standard is permitted. If you suspect your company's conditions or events may raise substantial doubt about its ability to continue as a going concern, contact your financial statement auditor to discuss steps to comply with the requirements.