

Case 12-08

Going, Going, Gone

First Class Telecommunications Inc. (“FCT” or “the Company”) is a leading regional wireless telecommunications service provider in the United States serving approximately 3 million wireless customers in markets in small cities and rural areas covering parts of seven states in the Midwest and Northeast. In addition to providing wireless service to subscribers (i.e., customers), the Company also sells cell phones. The Company has two operating segments: retail (selling of cell phones) and services (providing wireless service). See Appendix A for financial highlights and excerpts from a draft of FCT’s 2012 Form 10-K.

In addition, the entity has debt totaling \$200 million. The debt has financial covenants as well as a material adverse change clause, which if triggered may result in the lender demanding full payment of all outstanding amounts. See Appendix B-1 for the audit team’s debt compliance memo and Appendix B-2 for management’s calculation of the actual covenant ratio calculation as of December 31, 2012, as well as the projected covenant ratio calculations for each of the quarter-ends in FY2013.

Finally, before the annual assessment of goodwill performed at year-end, FCT had goodwill of \$230 million recorded on its books. As of the testing date, the team is not aware of any events or circumstances that would have resulted in an impairment of goodwill since the December 31, 2011, assessment. During the annual goodwill impairment analysis as of December 31, 2012, the Company did not elect the option of performing a Step 0 assessment of goodwill under ASC 350-20-35, but rather elected to start with the Step 1 approach discussed in ASC 350-20-35-4. The Company determined both segments passed the first step of the goodwill impairment test. Refer to Appendix C for excerpts of the valuation analysis provided to the audit team directly from management’s third-party valuation firm, VALU.

Required:

1. Read and consider the information in Appendixes A through C. What events or conditions may cause substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time?
2. Assuming the events or conditions identified in Question 1 cause the audit team to believe substantial doubt exists about FCT’s ability to continue as a going concern for a reasonable period of time, what are the next steps the audit team needs to perform?
3. Upon completing the steps in (2) above, the engagement team obtained additional information from management included in Appendix D. Read and consider this information and determine what type of audit evidence the audit team may consider obtaining, or what type of audit procedures it may perform, to confirm or dispel whether there is substantial doubt about FCT’s ability to continue as a going concern for a reasonable period of time?
4. After considering identified conditions and events and management’s plans, assume that the audit team concluded that as of December 31, 2012, there is not substantial doubt about FCT’s ability to continue as a going concern for a reasonable period. What are the

audit team’s responsibilities regarding its consideration of the Company’s ability to continue as a going concern during its review of the Company’s interim financial information for the three months ended March 31, 2013?