

## Heads Up

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

## Going, Going, Gone! FASB Issues ASU on Going Concern

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On August 27, 2014, the FASB issued [ASU 2014-15](#),<sup>1</sup> which provides guidance on determining when and how to disclose going-concern uncertainties in the financial statements. The new standard requires management to perform interim and annual assessments of an entity's ability to continue as a going concern within one year of the date the financial statements are issued.<sup>2</sup> An entity must provide certain disclosures if "conditions or events raise substantial doubt about [the] entity's ability to continue as a going concern." The ASU applies to all entities and is effective for annual periods ending after December 15, 2016, and interim periods thereafter, with early adoption permitted.

This *Heads Up* provides background on the ASU and summarizes its key provisions. [Appendix A](#) contains decision flowcharts adapted from the ASU that summarize going-concern disclosure considerations. [Appendix B](#) compares the ASU to current PCAOB auditing literature.

### Background

Under U.S. GAAP, an entity's financial reports reflect its assumption that it will continue as a going concern until liquidation is imminent.<sup>3</sup> However, before liquidation is deemed imminent, an entity may have uncertainties about its ability to continue as a going concern. Because there are no specific requirements under current U.S. GAAP related to disclosing such uncertainties, auditors have used applicable auditing standards<sup>4</sup> to assess the nature, timing, and extent of an entity's disclosures, which has resulted in diversity in practice. The ASU is intended to alleviate that diversity.

The ASU extends the responsibility for performing the going-concern assessment to management and contains guidance on (1) how to perform a going-concern assessment and (2) when going-concern disclosures would be required under U.S. GAAP. The FASB believes that requiring management to perform the assessment will enhance the timeliness, clarity, and consistency of related disclosures and improve convergence with IFRSs (which emphasize management's responsibility for performing the going-concern assessment). However, the time horizon for the assessment (look-forward period) and the disclosure thresholds under U.S. GAAP and IFRSs will continue to differ.

<sup>1</sup> FASB Accounting Standards Update No. 2014-15, *Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern*.

<sup>2</sup> An entity that is neither an SEC filer nor a conduit bond obligor for debt securities that are traded in a public market would use the date the financial statements are available to be issued (in a manner consistent with the ASU's definition of "issued").

<sup>3</sup> In accordance with FASB Accounting Standards Codification Subtopic 205-30, *Presentation of Financial Statements: Liquidation Basis of Accounting*, once liquidation is deemed imminent, an entity must apply the liquidation basis of accounting.

<sup>4</sup> PCAOB AU Section 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.

**Editor’s Note:** As a result of the ASU’s extension of the going-concern assessment to management, entities may need to implement and document their processes and controls, which would require the use of judgment. The costs of complying with the ASU are likely to be greatest for entities that are not financially strong since such entities would need to perform a more robust evaluation.

## Key Provisions of the ASU

### Disclosure Thresholds

An entity would be required to disclose information about its potential inability to continue as a going concern when “substantial doubt” about its ability to continue as a going concern exists, which the ASU defines as follows:

Substantial doubt about an entity’s ability to continue as a going concern exists when conditions and events, considered in the aggregate, indicate that it is probable that the entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued . . . . The term *probable* is used consistently with its use in Topic 450 on contingencies.

In applying this disclosure threshold, entities would be required to evaluate “relevant conditions and events that are known and reasonably knowable at the date that the financial statements are issued.” Reasonably knowable conditions or events are those that can be identified without undue cost and effort.

The ASU provides examples of events that suggest that an entity may be unable to meet its obligations. These examples, which are consistent with those in auditing literature,<sup>5</sup> include the following:

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

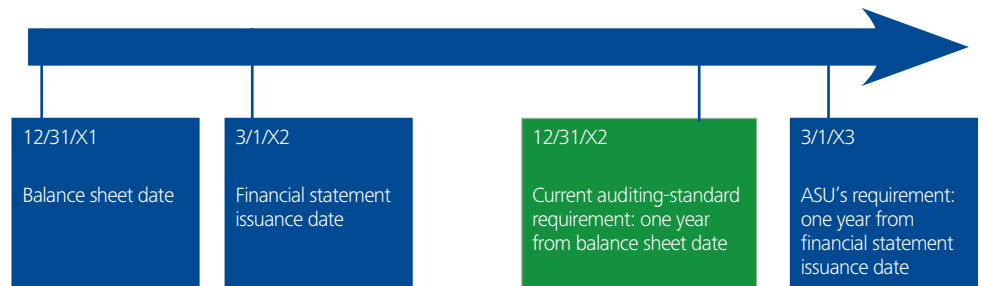
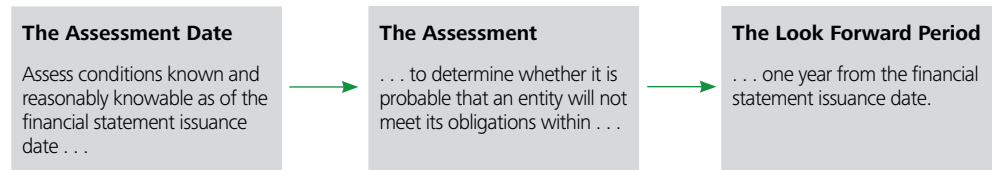
An entity would be required to disclose information about its potential inability to continue as a going concern when “substantial doubt” about its ability to continue as a going concern exists.

**Editor’s Note:** Under current auditing standards, an auditor is required to evaluate the adequacy of going-concern disclosures after concluding that there is **substantial doubt** about the entity’s ability to continue as a going concern for a reasonable period. The ASU uses a “probable” threshold to define substantial doubt (see the definition above), whereas the auditing literature does not explicitly define substantial doubt and instead provides qualitative factors for entities to consider. The ASU’s basis for conclusions notes that some auditors and stakeholders view the existing substantial-doubt threshold as a lower threshold than the new “probable” threshold (with one academic study noting that a threshold of between 50 and 70 percent is used for substantial doubt, and certain comment letter responses indicating that a threshold of greater than 70 percent is used for probable). As a result, there could be fewer going-concern disclosures under the ASU than there are under current guidance.

<sup>5</sup> PCAOB AU Section 341.06.

## Time Horizon

In each reporting period (including interim periods), an entity would be required to assess its ability to meet its obligations as they become due for one year after the date the financial statements are issued. In the following illustration, adapted from a [handout](#) for the FASB’s May 7, 2014, meeting, the look-forward period is illustrated and compared to current auditing standards:



In each reporting period (including interim periods), an entity would be required to assess its ability to meet its obligations as they become due for one year after the date the financial statements are issued.

**Editor’s Note:** The ASU’s assessment period is longer than that in current auditing literature, which requires auditors to “evaluate whether there is substantial doubt about an entity’s ability to continue as a going concern for a reasonable period of time, **not to exceed one year** beyond the date of the financial statements being audited” (emphasis added).<sup>6</sup> For users, the benefits of this change include (1) more current and relevant information; (2) potentially earlier disclosures about a going-concern issue; (3) a look-forward period that is still one year, even if financial statement issuance is delayed; and (4) inclusion of known events in the substantial-doubt assessment after one year from the balance sheet date. Implications of the change in the look-forward period for entities applying the standard include the need to change forecasting to reflect the period as modified, which may be a period that is not typically assessed, and a potential need to obtain debt covenant waivers for an additional period.

The change in the look-forward period is expected to have a greater impact on private entities, which typically issue financial statements later than public entities and may not prepare rolling forecasts. Users of private entities’ financial statements will often benefit from having a significantly longer look-forward period over which the going-concern presumption is assessed.

<sup>6</sup> PCAOB AU Section 341.02.

## Disclosure Content

The disclosure requirements in the ASU closely align with those under current auditing literature. If an entity triggers the substantial-doubt threshold, its footnote disclosures must contain the following information, as applicable:

Substantial Doubt Is Raised but Is Alleviated by Management's Plans	Substantial Doubt Is Raised and Is Not Alleviated
<ul style="list-style-type: none"> <li>• Principal conditions or events.</li> <li>• Management's evaluation.</li> <li>• Management's plans.</li> </ul>	<ul style="list-style-type: none"> <li>• Principal conditions or events.</li> <li>• Management's evaluation.</li> <li>• Management's plans.</li> <li>• Statement that there is "substantial doubt about the entity's ability to continue as a going concern."</li> </ul>

The ASU explains that these disclosures may change over time as new information becomes available and that disclosure of how the substantial doubt was resolved is required in the period that substantial doubt no longer exists (before or after consideration of management's plans). The ASU also states that the mitigating effects of management's plans to alleviate substantial doubt should be evaluated only if (1) the plans are approved before the financial statement issuance date and (2) both of the following conditions are met:

- "It is probable that management's plans will be effectively implemented within one year after the date that the financial statements are issued."
- "It is probable that management's plans, when implemented, will mitigate the relevant conditions or events that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued."

The disclosure requirements in the ASU closely align with those under current auditing literature.

## Effective Date

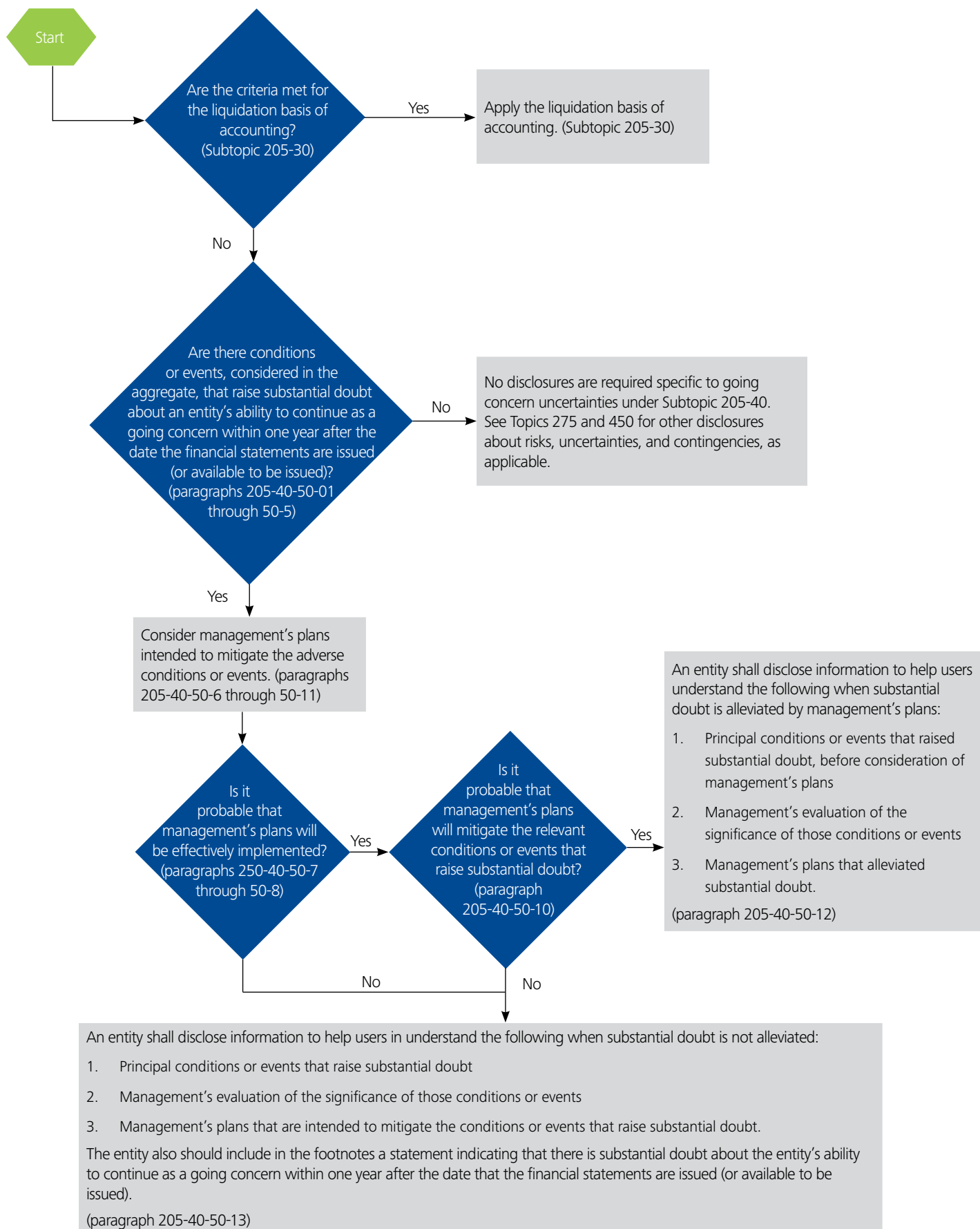
The guidance in the ASU would be "effective for annual periods ending after December 15, 2016, and interim periods within annual periods beginning after December 15, 2016." Early application is permitted.

**Editor's Note:** The PCAOB and the AICPA's Auditing Standards Board may consider revising their auditing standards to conform to the ASU (see Deloitte's July 14, 2014, *Heads Up*). Auditors should monitor developments by these standard setters and be mindful that the ASU does not supersede auditing standards.

During the FASB's redeliberations in May 2014, the Board discussed the possibility that auditing standards would not be updated to conform to the ASU by the effective date. While the ASU is generally consistent with auditing standards, one technical difference is that the look-forward period in existing auditing literature is shorter than that in the ASU. The FASB stated that it would not expect the technical difference to result in a practical difference; thus, the Board would expect auditors to disclose a going-concern issue in the auditor opinion if management discloses a going-concern issue in the notes to the financial statements.

# Appendix A — Decision Flowchart

The flowchart below is reproduced from the ASU and depicts the decision process an entity could use in determining whether going-concern disclosures are required.



## Appendix B — Comparison of ASU to Current Auditing Literature

The table below, adapted from an exhibit in a [handout](#) for the FASB’s May 7, 2014, meeting compares the ASU with the PCAOB’s current auditing literature.

Topic	ASU	Current Auditing Literature (PCAOB AU 341)
Going-concern presumption	Not specifically defined. However, it clarifies that the continuation of an entity as a going concern is presumed until its liquidation is imminent.	Not specifically defined. However, it states that information to the contrary may be related to the entity’s inability to continue to meet its obligations without substantial disposition of assets outside the ordinary course of business, restructuring of debt, externally forced revisions of its operations, or similar actions.
Substantial doubt	Probable that the entity will be unable to meet its obligations (sample indicators provided).	Substantial doubt is not defined (sample indicators provided).
Assessment basis and date	Conditions known and reasonably knowable as of the financial statement issuance date.	Conditions as of the date of the auditor’s report (generally on or around the financial statement issuance date).
Look-forward period	One year from the financial statement issuance date.	The assessment period (i.e., “reasonable period of time”) is a period not to exceed one year from the balance sheet date.
Disclosures before substantial doubt or Additional disclosure	No disclosures before substantial doubt, but . . . ... some disclosures are required when management alleviates substantial doubt (see “Disclosure content” below).	No disclosure before substantial doubt.  Disclosures considered (but not required) when management alleviates substantial doubt. However, these disclosures are common in practice.
Disclosure content	<p><b>When substantial doubt is raised but is alleviated by management’s plans, disclose:</b></p> <ul style="list-style-type: none"> <li>• Principal conditions or events.</li> <li>• Management’s evaluation.</li> <li>• Management’s plans.</li> </ul> <p><b>When substantial doubt is raised and is not alleviated, disclose:</b></p> <ul style="list-style-type: none"> <li>• Principal conditions or events.</li> <li>• Management’s evaluation.</li> <li>• Management’s plans.</li> <li>• Statement that there is “substantial doubt about the entity’s ability to continue as a going concern.”</li> </ul>	<p><b>When substantial doubt is raised but is alleviated by management’s plans, disclose:</b></p> <ul style="list-style-type: none"> <li>• Principal conditions.</li> <li>• The possible effect.</li> <li>• Mitigating factors, including management’s plans.</li> </ul> <p><b>When substantial doubt is raised and is not alleviated, disclose:</b></p> <ul style="list-style-type: none"> <li>• Principal conditions.</li> <li>• The possible effect.</li> <li>• Management’s evaluation.</li> <li>• Possible discontinuation of operations.</li> <li>• Management’s plans (and relevant prospective financial information).</li> <li>• Information about the recoverability or classification of recorded asset amounts or the amounts or classification of liabilities.</li> </ul>
Frequency of assessment	<b>Annual</b> and <b>interim</b> periods.	Every audit (generally <b>annual only</b> ; however, in practice may be performed during interim periods, although not required).
Nonpublic entities	No exceptions.	No exceptions.

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