



Agenda Item 3

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

Objective of Agenda Item

To review the draft of the proposed SAS No. 126, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern (Revised)* (SAS No. 126 or AU-C section 570), and the proposed amendments to AU-C section 930, *Interim Financial Information*.

Task Force members are:

- Marc Panucci—PwC (Chair)
- Aron Dunn—Allen, Gibbs & Houlik (ARSC)
- Jennifer Haskell—D&T
- Mike Santay—GT
- Chris Smith—BDO
- Michael Westervelt—CliftonLarson (TIC)

Exhibit A to this issues paper describes the background of this project.

Issues for Discussion

Auditor Reporting Issues

At its October 2015 meeting, the ASB discussed the options related to auditor reporting when the financial reporting framework requires management to disclose that substantial doubt exists about the entity's ability to continue as a going concern. The ASB agreed on the following matters:

- 1) From a performance perspective, the auditor is required to independently conclude whether there is substantial doubt about an entity's ability to continue as a going concern.
- 2) As it relates to the reporting, require an emphasis-of-matter paragraph that should be modeled after the IAASB's auditor's report section on material uncertainty related to going concern. This model highlights at the beginning of the auditor's report section on material uncertainty related to going concern, the note(s) that contain management's

disclosure instead of trying to distinguish whether there is a separate auditor conclusion or not.

- 3) Application guidance be included that the auditor may include an emphasis-of-matter paragraph if management includes conditions or events related to the entity's ability to continue as a going concern but substantial doubt has been alleviated.
- 4) Address in application guidance going concern considerations in audits of Special Purpose Frameworks and audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement.

The Task Force agreed with the ASB' recommendations, and in response, suggests the following revisions to the proposed SAS:

- 1) With respect to the wording of the emphasis-of-matter paragraph when the financial reporting framework requires management to disclose that substantial doubt exists, the Task Force proposes to amend the paragraph to model the language from ISA 570. In developing the illustrative language, the Task Force concluded that discussing substantial doubt first when the financial reporting framework requires management to make that statement was clearer and helped distinguish it from the illustration when management is not required to make such a statement. This is slightly different than ISA 570.

The Task Force also proposes to include an illustrative example in the application guidance when the auditor concludes that substantial doubt exists but management has no requirement under the financial reporting framework to disclose that substantial doubt exists. This model is based off extant AU-C section 570. The illustrations are as follows:

When the Financial Reporting Framework Requires Management to Disclose that Substantial Doubt Exists

A42.

...

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As stated in Note X, the Company has included a statement that substantial doubt exists about the Company's ability to continue as a going concern. The Company has suffered recurring losses from operations and has a net capital deficiency; these events, conditions, and management's plans regarding 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. Our opinion is not modified with respect to this matter.

When the Financial Reporting Framework does not Require Management to Disclose that Substantial Doubt Exists

A43.

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. Our opinion is not modified with respect to this matter.

- 2) To address situations when the auditor judges it necessary to include an emphasis-of-matter paragraph in situations when conditions or events related to the entity's ability to continue as a going concern are identified and disclosed but substantial doubt has been alleviated as a result of management's plans, the task force suggests the following application guidance be included:

A44. If conditions or events have been identified that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time but, based on the audit evidence obtained, the auditor concludes, that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time has been alleviated by management's plans, the auditor may include an emphasis-of-matter paragraph in accordance with AU-C Section 706 making reference to management's disclosures related to the conditions or events and that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time has been alleviated.

- 3) In response to the ASB's recommendation to add additional application guidance to address audits of special purpose frameworks, single financial statements, or elements of a financial statement, the Task Force suggests the following amendments:
- a. Expand the scope of the proposed SAS to include audits of single financial statements or elements of a financial statements as follows:
 - 1...This SAS applies to all audits of financial statements, single financial statements, and specific elements of a financial statement regardless of whether the financial statements are prepared in accordance with a general purpose or a special purpose framework.
 - b. Included application guidance to address audits of special purpose frameworks, single financial statements, or elements of a financial statement as follows:

A1. Special purpose financial statements may or may not be prepared in accordance with a financial reporting framework for which the going concern basis of accounting is applied.

A2. AU-C section 800 states that in an audit of special purpose financial statements when the special purpose financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP, the auditor should evaluate whether the financial statements include informative disclosures similar to those required by GAAP. The auditor should also evaluate whether additional disclosures, beyond those specifically required by the framework, related to matters that are not specifically identified on the face of the financial statements or other disclosures are necessary for the financial statements to achieve fair presentation.

A3. AU-C section 805 states that when forming an opinion and reporting on a single financial statement or a specific element of a financial statement, the auditor should apply the requirements in section 700, *Forming an Opinion and Reporting on Financial Statements*, adapted as necessary in the circumstances of the engagement. AU-C section 805 further states that section 700 requires the auditor, in forming an opinion, to evaluate whether the financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements.

A4. As a result, regardless if special purpose financial statements or single financial statement or specific element of a financial statement are prepared in accordance with a financial reporting framework for which the going concern basis of accounting is not applied, the auditor has responsibilities to obtain sufficient appropriate audit evidence on whether conditions or events that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time exist in order to evaluate whether disclosures related to those conditions or events and management's plans are needed in order to achieve a fair presentation. If the auditor has already included an emphasis-of-matter paragraph related to substantial doubt about the entity's ability to continue as a going concern in the auditor's report of the general purpose financial statements; then, the auditor may reference this emphasis-of-matter paragraph in the audit of a special purpose framework, single financial statement, or specific element of a financial statement instead of repeating the emphasis-of-matter paragraph.

It should be noted that paragraph A17 of AU-C section 805 provides the source, in part, of paragraph A3 above. Paragraph A17 provides further guidance on what is meant by enabling intended users to understand the effect of material transactions and events on the information

conveyed in the financial statements and specifically highlights information conveyed in the financial statement or the specific element. Based on the direction of the ASB and based on the presumption that the majority of the financial statements will be prepared using GAAP or another financial reporting framework that considers going concern the basis of accounting (subject to the discussion beginning in the next paragraph), the Task Force believes that an evaluation of substantial doubt about an entity's ability to continue as a going concern would be necessary based on the guidance provided by paragraph A17. If the single financial statement or a specific element of a financial statement is a special purpose framework that does not consider going concern as the basis of accounting then the evaluation would be necessary based upon the proposed application guidance above that includes referencing the guidance in AU-C section 800.

However, the proposed new application guidance in paragraphs A2 and A3 would suggest that the auditor evaluate whether additional disclosures, beyond those specifically required by the framework, related to matters that are not specifically identified on the face of the financial statements or other disclosures are necessary for the financial statements to achieve fair presentation. The Task Force believes that the work effort is most likely unknown and inconsistent when the going concern basis of accounting is not applied (for example, special purpose framework) or when going concern may not inherently be relevant to a single financial statement or a specific element of a financial statement (for example, statement of revenues and expenses). The Task Force considered different options and wanted to seek the Board's input on which to explore:

- Provide additional application guidance on how to evaluate whether additional disclosures are needed under the situations described above. Application guidance might be difficult to develop as requirements might be needed and it is hard to be consistent with section 800 and 805 beyond what has already been included in A1-A4 above. If application guidance was developed, it might be limited to whether the auditor is aware of anything based on the engagement or, if applicable, the audit of the general purpose financial statements that leads the auditor to further evaluate. Specific questions could be included in the exposure draft related to any application guidance developed.
- Expose it as is (subject to any input from the ASB) as developing the guidance without feedback might be difficult and ask specific questions related to the topic, including what procedures/work effort might be needed.
- Consider whether amendments should be made to 800 and 805 to discuss the responsibility of the auditor to evaluate whether disclosures are needed related to risk and uncertainties in achieving fair presentation in those engagements instead of connecting the additional disclosures to the going concern basis of accounting and the work effort in AU-C section 570. This is based, in part, that if the going concern basis of accounting is not applied, then a statement related to substantial doubt may not be relevant in the situations discussed above. Under this option application guidance might be needed in AU-C sections 800 and 805 compared to AU-C section 570.

The Task Force also discussed it is important that the topic of special purpose financial statements and a single financial statement or specific element of a financial statement not hold up the overall timing of the project due to the importance of issuing an updated AU-C section 570 standard since the FASB subtopic is effective for annual periods ending after December 15, 2016.

The Task Force also considered whether the additional guidance should be included to address AU-C section 810, *Engagements to Report on Summary Financial Statements*. The Task Force did not consider it necessary to address AU-C section 810 in this proposed SAS, because paragraph 20 of AU-C section 810 already requires that if the auditor's report on the main financial statements contains an emphasis-of-matter paragraph, the auditor's report on the summary financial statements should state that fact and describe the emphasis-of-matter paragraph and the effect on the summary financial statements, if any.

Expected ASB Action

Does the ASB agree with the proposed amendments to wording of the emphasis-of-matter paragraphs under the two illustrations described above?

Does the ASB agree with the application guidance related to reporting when substantial doubt has been alleviated by management's plans?

Does the ASB agree with the amendments to paragraph 1 to expand the scope of the proposed standard to audits of special purpose frameworks, single financial statements, elements of a financial statement? Does the ASB have a view and a preferred path related to the options outlined above?

Does the ASB agree with the decision not to include additional guidance about situations involving audits of summary financial information?

Interim Financial Information

In October 2015, the ASB debated the issues of interim financial information and the options for the auditor to report thereon when management is required by the financial reporting framework to conclude on whether there is substantial doubt about an entity's ability to continue as a going concern in an interim period. The ASB opted for a model to continue requiring performing review procedures and mandating an emphasis-of-matter paragraph in the auditor's report when management discloses that substantial doubt exists about an entity's ability to continue as a going concern.

The Task Force agreed with the ASB's recommendations. However, upon further reflection, the Task Force considered it necessary to include requirements and related illustrative examples of emphasis-of-matter paragraphs to address the various circumstances that might arise in reviews of interim financial information. The additional proposed requirements are as follows:

36a. The auditor should include an emphasis-of-matter paragraph in the auditor's review report in any of the following circumstances:

- a. An emphasis-of-matter paragraph when a going concern emphasis-of-matter paragraph was included in the prior year's auditor's report, and:
 - i. conditions or events giving rise to the emphasis-of-matter paragraph continue to exist;
 - ii. conditions or events raise substantial doubt about an entity's ability to continue as a going concern and management's plans do not alleviate them; and
 - iii. the Company is required under the financial reporting framework to include a statement in the notes to the financial statement that substantial doubt exists;
- b. An emphasis-of-matter paragraph when a going concern emphasis-of-matter paragraph was included in the prior year's auditor's report, and
 - i. same as *a(i) – (ii)* above, and
 - ii. the Company is not required under the financial reporting framework to include a statement in the notes to the financial statement that substantial doubt exists;
- c. An emphasis-of-matter paragraph when a going concern emphasis-of-matter paragraph was not included in the prior year's auditor's report, and:
 - i. management is required under the financial reporting framework to include a statement in the notes to the financial statements that substantial doubt exists; and
 - ii. management has included such statement in the notes to the financial statements

In addition, the Task Force recommends adding an application guidance paragraph to address situations when conditions or events are identified but substantial doubt is alleviated or the financial reporting framework does not require a statement in the notes that substantial doubt exists as follows:

A48b If conditions or events have been identified during the interim review that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time but no statement is included in the notes to the financial statements because management's plans have alleviated the substantial doubt or a statement is not required to be included in the notes to the financial statements, the auditor may include an emphasis-of-matter paragraph in accordance with AU-C Section 706 if management has disclosed in the notes to the financial statements the conditions or events.

The related illustrative examples of emphasis-of-matter paragraphs are included in Exhibit D of the proposed amendments to AU-C section 930.

In addition the Task Force proposes to amend AU-C section 930 to include a requirement when the applicable financial reporting framework requires management to assess the entity's ability to continue as a going concern for a reasonable period of time in preparing interim financial statements, the auditor should perform interim review procedures related to management's assessment and the adequacy of the related disclosures in the interim financial information. This requirement is consistent with the interpretations issued in January 2015. See paragraph 15a for the requirement and paragraphs A23a and A23b for the application guidance in the proposed amendments to AU-C section 930.

Expected ASB Action

Does the ASB agree with the additional requirements in the proposed SAS to address the various circumstances that might arise in a review of interim financial information engagements?

Does the ASB agree with the additional application guidance paragraph to address situations when conditions or events are disclosed but management has not included a statement in the notes that substantial doubt exists and the conditions and events did not exist in the prior year?

Does the ASB agree with the inclusion and wording of the illustrative examples of emphasis-of-matter paragraphs?

Does the ASB agree with the requirement and application guidance related to performing interim review procedures when the applicable financial reporting framework includes a requirement for management to assess the entity's ability to continue as a going concern for a reasonable period of time in preparing interim financial statements?

Reasonable Period of Time

The ASB discussed the Task Force's proposed changes to the definition of reasonable period of time and the related changes to the application guidance. Under the proposal, the definition of reasonable period of time would be either as defined by the applicable financial reporting framework or at least twelve months from the date of the financial statements are issued or available to be issued. The ASB agreed with the Task Force's recommendations but directed the Task Force to consider adding application guidance to address audits of financial statements prepared using Special Purpose Frameworks. The Task Force agreed with the ASB's recommendation and, in response, recommends adding the following application paragraph:

A11. Paragraph A1 explains that in an audit of special purpose financial statements when the special purpose financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP, the auditor is required to evaluate whether the financial statements include informative disclosures similar to those required by GAAP. This evaluation would include following the definitions set out in GAAP, for example, the definition of reasonable period of time. Similarly, if the special purpose frameworks contain items that are the same as, or similar to, those in financial statements prepared in accordance with a framework other than

GAAP, the auditor's evaluation would follow the definitions set out by that reporting framework.

The ASB also discussed the Task Force's proposal of including paragraph 15 (now paragraph 16 as a result of changes to the proposed SAS) of ISA 570, *Going Concern*, which addresses the auditor making inquiries of management as to its knowledge of conditions or events beyond the period of management's assessment. The ASB expressed concern about including paragraph 15 in all cases, because it would extend the reasonable period of time required under certain financial reporting frameworks. The ASB suggested that the Task Force consider revising the requirement in paragraph 15 and making it more specific to financial reporting frameworks that define reasonable period of time as a minimum time period, for example, IFRS whose definition of reasonable period of time is at least, but not limited to, twelve from the date of the financial statements.

In response to the ASB's comments, the Task Force drafted amendments to the paragraph to make it clear that the only circumstance in which the auditor would be required to make inquiries of management as to its knowledge of conditions or events beyond the period of management's assessment would be situation where reasonable period of time is defined as a minimum. See marked changes to paragraph 16 below. However, upon reflection, the Task Force expressed reservation about limiting the requirement to situations in which the applicable financial reporting framework is expressed as a minimum time period. The Task Force believes that the requirement should be applicable in all circumstances as the inquiry is limited to whether management has knowledge of conditions or events beyond the period of management's assessment. Those conditions or events may have an impact on whether there is substantial doubt or it may have an impact related to other disclosures. This, in effect, would mean not making the suggested edits. If the ASB agreed to continue to limit this when the reasonable period of time is defined as a minimum time period, the revised requirement as suggested by the Task Force would read as follows:

16. In audits of financial statements in which the reasonable period of time defined by the applicable financial reporting framework is expressed as a minimum time period, the auditor should inquire of management as to its knowledge of conditions or events beyond the period of management's assessment that raise substantial doubt about the entity's ability to continue as a going concern.

In addition, the Task Force suggests adding an application guidance paragraph to provide an example as follows:

A25. An example of a financial reporting framework that defines reasonable period of time as a minimum time period is IFRS as the reasonable period of time is defined as "at least, but not limited to, one year from the end of the reporting period."

Finally, the Task Force suggests adding the following application guidance at the end of paragraph A26 to make it clear that even though a framework may not define a reasonable period of time as a minimum, the financial reporting framework may contain other disclosure requirements that should still should be considered related to the conditions or events:

A26...Some financial reporting frameworks may not define reasonable period of time as a minimum time period. Nevertheless, the financial reporting framework may have other disclosure requirements about the conditions or events that may need to be considered even if not part of management's assessment of the entity's ability to continue as a going concern.

Expected ASB Action

Does the ASB agree with the additional application guidance paragraph to the definition of reasonable period of time in order to address audits of special purpose frameworks?

What are the ASB' views about the modifications to paragraph 16 and the proposed changes to the related application guidance which would limit the application of this paragraph to situations where the definition of reasonable period of time is expressed as a minimum time period? Or, does the ASB prefer reverting to the original version that the requirements in paragraph 16 would be applicable in all circumstances?

Disclaimer of Opinion

At the October 2015 meeting, the ASB made the recommendation that the Task Force consider including an illustrative example of a disclaimer of opinion relating to uncertainties. See paragraph 27 of the proposed SAS. Upon reflection, the Task Force does not recommend that an illustration of a disclaimer related to uncertainties be included because such situations are expected to be rare (see paragraph A48 of the proposed SAS) and with more financial reporting frameworks requiring management to assess its ability to continue as a going concern it should become even more uncommon. The Task Force believes if an illustration is included it might promote a practice that is expected to be rare.

Reissued Reports

Paragraph 31 addresses situations in which the auditor may be requested to reissue an auditor's report. The Task Force raised the issue that neither paragraph 31 nor the application guidance address the reasonable period of time that the reissued report should cover. In looking at the FASB subtopic, the accounting guidance does not address reissuance situations either. When the assessment is tied to the issuance date (or available to be issued) it raises the question whether in a re-issuance situation the assessment is from the original issuance date or does it "re-start" with the re-issuance date? The Task Force believes that in reissuance situations the reasonable period of time would be from the original issuance date, but the Task Force acknowledges as it relates to the FASB subtopic it might be more of an accounting question compared to an auditing question. This is also consistent with consideration of dating the auditor's report as most re-issuances do not impact the date of the auditor's report. The Task Force did not include any guidance in the proposed SAS as we wanted to first get the views of the ASB, including whether this is more of an accounting question when the applicable accounting framework ties the assessment to the issuance date (or available to be issued).

Expected ASB Action

Does the ASB agree with the decision to not include an illustration of a disclaimer related to uncertainties?

Does the ASB agree with the Task Force's position with respect to the reasonable period of time in reissuance situations? Does the ASB believe AU-C section 570 should include guidance or is this more of an accounting question?

Items Presented

Agenda Item 3 – Issues Paper

Agenda Item 3A – Proposed AU-C section 570

Agenda Item 3B – Proposed conforming amendments to AU-C section 930

Mr. Panucci will refer to the Issues Paper and agenda items 3A and 3B in leading the discussion.

Background

ASB

In January 2015, the Auditing Standards Board (ASB) issued four new auditing interpretations to SAS No. 126 (the Interpretations). The issuance of these Interpretations represented a short-term initiative by the ASB to address the more significant consequential effects of the FASB Accounting Standards Update (ASU) No. 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* and GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards* (GASB No. 56). Subtopic 205-40 is effective for annual periods ending after December 15, 2016, and for interim periods thereafter with early application permitted. GASB No. 56 is currently in effect.

The interpretations addressed the following topics:

- a. Definition of Substantial Doubt About an Entity’s Ability to Continue as a Going Concern
- b. Definition of Reasonable Period of Time
- c. Interim Financial Information, and
- d. Consideration of Financial Statements Effects

The Interpretations are included as an exhibit to this issues paper as a reminder of their content. One of the principles in developing the Interpretations was that the auditor should follow the same model to determine whether substantial doubt exists as required by the applicable financial reporting framework for management, if applicable.

At the time the ASB decided to issue the Interpretations, it contemplated that in the long-term, the ASB would undertake a more comprehensive or holistic project to amend AU-C section 570 and align it with the various accounting and auditing standards.

The Auditor Reporting Task Force is leading a project to revise the suite of auditor reporting standards using the IAASB revised auditor reporting standards as a base.

IAASB

At its September 2014 meeting, the IAASB approved to issue the standards and conforming amendments related to its Auditor Reporting Standards, which included a revised ISA 570. The following are the key aspects of the ISA 570 (Revised):

1. *Exception-Based Reporting*—The IAASB decided to retain the exception-based reporting model, that is, including discussion in the auditor’s report only in situations where a

material uncertainty (MU) related to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern has been identified.

2. *Expansion of Management's and Auditor's Responsibilities*—The IAASB decided that additional language would be useful in explaining both management's and the auditor's responsibilities with respect to going concern. This additional language will be included as part of the standard language for all reports regardless if there are events or conditions that have been identified that may cast significant doubt on the entity's ability to continue as a going concern.
3. *Close Call Situations*—The IAASB decided to address situations in which the auditor identifies events or conditions that may give rise to a material uncertainty but decides that no material uncertainty exists based on management's plan to alleviate the uncertainty (these situations are often referred to as "close calls").

The IAASB auditor reporting standards are effective for audits of financial statements for periods ending on or after December 15, 2016.

PCAOB

The PCAOB's agenda includes a project to consider revising its going concern standard, AU section 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* (AU 341).

On September 22, 2014, the PCAOB issued a Staff Audit Practice Alert to remind auditors to continue to follow existing PCAOB standards when considering a company's ability to continue as a going concern. Accordingly, a determination that no disclosure is required under the FASB or IAS 1 standards is not conclusive as to whether an explanatory paragraph is required under AU 341. Auditors should make a separate evaluation of the need for disclosure in the auditor's report in accordance with the requirements of AU 341.

The PCAOB is expected to issue a staff consultation paper related to the going concern standard soon. The follow-up to a staff consultation paper will be at least one proposal before the PCAOB approves a final standard and then any final standard is subject to SEC approval. As a result, the timing of a final standard is uncertain.

AITF

At its July 8, 2015 meeting, the AITF discussed the status of the Going Concern project. As explained above, the ASB decided that it would undertake a more comprehensive or holistic project to amend AU-C section 570 and align it with the various accounting and auditing standards. That strategy included considering the effects of any changes to the PCAOB's standards related to going concern. However, because the timing of the PCAOB Going Concern project is uncertain, it appears likely that the PCAOB revised standard may not be finalized by the time the FASB Subtopic 205-40 becomes effective or becomes effective right before the effective date of Subtopic 205-40.

An issue that the AITF discussed was whether the Interpretations issued by the ASB in January 2015 currently provide sufficient guidance to auditors or whether it is preferable to have a final AU-C 570 standard related to the performance requirements before the effective date of Subtopic 205-40, which means not waiting on the direction of the PCAOB.

The AITF directed the Task Force to move ahead and revise AU-C section 570 to consider Subtopic 205-40 and converge with the revised ISA 570 but only with respect to the performance requirements—not the reporting requirements—because such requirements will be addressed as part of the broader auditor reporting project.

AU-C Section 9570

The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern: Auditing Interpretations of AU-C Section 570

FASB and GASB Standards on Going Concern

In August 2014, FASB issued Accounting Standards Update (ASU) No. 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*. FASB Accounting Standards Codification (ASC) 205-40 provides guidance in U.S. generally accepted accounting principles (GAAP) about management's responsibility to evaluate an entity's ability to continue as a going concern and to provide related footnote disclosures. Previously, no such guidance existed in GAAP issued by FASB.

In summary, FASB ASC 205-40 provides the following new guidance as a result of the issuance of ASU No. 2014-15:

- a. Defines the term *substantial doubt about an entity's ability to continue as a going concern* (substantial doubt) 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 (or within one year after the date that the financial statements are available to be issued when applicable). The term *probable* is used consistently with its use in Topic 450 on contingencies.
- b. Requires an evaluation every reporting period, including interim periods
- c. Provides that the mitigating effect of management's plans should be considered only to the extent it is probable the plans will be effectively implemented and mitigate the conditions or events giving rise to substantial doubt
- d. Requires certain disclosures when substantial doubt is alleviated as a result of consideration of management's plans
- e. Requires an explicit statement in the footnotes that there is substantial doubt and other disclosures when substantial doubt is not alleviated
- f. Requires an evaluation for a period of one year after the date that the financial statements are issued (or available to be issued)

FASB ASC 205-40 applies to all entities required to comply with standards issued by FASB and becomes effective for annual periods ending after December 15, 2016, and for interim periods thereafter. Early application is permitted.

GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*, establishes requirements related to going concern for governmental entities and is currently effective. Although GASB Statement No. 56 generally adopted the guidance included in AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* (AICPA, *Professional Standards*), including providing indicators related to when there may be a substantial doubt about a governmental entity's ability to continue as a going concern, GASB made certain modifications to require that financial statement preparers evaluate whether there is substantial doubt about a governmental entity's ability to continue as a going concern for 12 months beyond the financial statement date. GASB Statement No. 56 further requires that if there is information currently known to the governmental entity that may raise substantial doubt shortly thereafter (for example, within an additional 3 months), such information also should be considered. Additionally, GASB Statement No. 56 establishes disclosure requirements when a governmental entity determines that there is substantial doubt.

1. Definition of *Substantial Doubt About an Entity's Ability to Continue as a Going Concern*

.01 *Question*—AU-C section 570 refers to the term *substantial doubt about an entity's ability to continue as a going concern* but does not define it. For example, AU-C section 570 requires the auditor to evaluate whether there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time.¹ In applying AU-C section 570, how should an auditor apply the term *substantial doubt about an entity's ability to continue as a going concern* when the term is defined in the applicable financial reporting framework?

.02 *Interpretation*—AU-C section 700, *Forming an Opinion and Reporting on Financial Statements* (AICPA, *Professional Standards*), requires the auditor to form an opinion on whether the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.² As a result, when the applicable financial reporting framework includes a definition of *substantial doubt about an entity's ability to continue as a going concern*, that definition would be used by the auditor when applying AU-C section 570. For example, if an entity is required to comply with, or has elected to adopt, FASB ASC 205-40 early, the definition of *substantial doubt about an entity's ability to continue as a going concern* set out in FASB ASC 205-40 would be used by the auditor.

¹ Paragraph .08 of AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* (AICPA, *Professional Standards*).

² Paragraph .13 of AU-C section 700, *Forming an Opinion and Reporting on Financial Statements* (AICPA, *Professional Standards*).

[Issue Date: January 2015.]

2. Definition of *Reasonable Period of Time*

.03 *Question*—AU-C section 570 requires the auditor to evaluate whether there is substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time.³ AU-C section 570 defines *reasonable period of time* as “a period of time not to exceed one year beyond the date of the financial statements being audited.”⁴ How should an auditor apply this definition when the applicable financial reporting framework requires management to evaluate whether there are conditions and events that raise substantial doubt for a period of time greater than one year from the date of the financial statements?

.04 *Interpretation*—As noted in Auditing Interpretation No. 1, “Definition of *Substantial Doubt About an Entity’s Ability to Continue as a Going Concern*,” the auditor is required to form an opinion on whether the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.⁵ As a result, when the applicable financial reporting framework requires management to evaluate whether there are conditions and events that raise substantial doubt for a period of time greater than one year from the date of the financial statements, the auditor’s assessment of management’s going concern evaluation would be for the same period of time as required by the applicable financial reporting framework in forming an opinion on whether the financial statements are presented fairly, in all material respects, and determining whether an emphasis-of-matter paragraph is required.

.05 For example, if an entity is required to comply with, or has elected to adopt, FASB ASC 205-40 early, the auditor’s assessment of management’s going concern evaluation would need to be for the same period of time as required by FASB ASC 205-40 (that is, one year after the date that the financial statements are issued or available to be issued) in forming an opinion on whether the financial statements are presented fairly, in all material respects, and determining whether an emphasis-of-matter paragraph is required.

[Issue Date: January 2015.]

3. Interim Financial Information

.06 *Question*—AU-C section 930, *Interim Financial Information* (AICPA, *Professional Standards*), states that the objective of the auditor when performing an engagement to review interim financial information is to obtain a basis for reporting whether the auditor is aware of any material modifications that should be made to the interim financial information for it to be in accordance with the applicable financial reporting framework through performing limited

³ Paragraph .08 of AU-C section 570.

⁴ Paragraph .07 of AU-C section 570.

⁵ Paragraph .02 of Auditing Interpretation No. 1, “Definition of *Substantial Doubt About an Entity’s Ability to Continue as a Going Concern*,” of AU-C section 570 (AICPA, *Professional Standards*, AU-C sec. 9570 par. 01–.02).

procedures.⁶ AU-C section 930 addresses the auditor's responsibility about when to make an inquiry concerning an entity's ability to continue as a going concern.⁷

.07 What are the auditor's responsibilities when the applicable financial reporting framework contains explicit requirements concerning management's responsibilities related to evaluating the entity's ability to continue as a going concern for interim financial information (for example, if an entity is required to comply with, or has elected to adopt, FASB ASC 205-40 early, management is required to comply with FASB ASC 205-40 when preparing interim financial information, including, when applicable, providing disclosures if substantial doubt about an entity's ability to continue as a going concern exists or has been alleviated)?

.08 *Interpretation*—In accordance with AU-C section 930, if (a) conditions or events that may indicate substantial doubt about an entity's ability to continue as a going concern existed at the date of prior period financial statements, regardless of whether the substantial doubt was alleviated by the auditor's consideration of management's plans, or (b) in the course of performing review procedures on the current period interim financial information, the auditor becomes aware of conditions or events that might be indicative of the entity's possible inability to continue as a going concern, the auditor is required to

- a. inquire of management about its plans for dealing with the adverse effects of the conditions and events, and
- b. consider the adequacy of the disclosure about such matters in the interim financial information.⁸

The consideration of the adequacy of management's disclosures about the entity's ability to continue as a going concern in the interim financial information includes a consideration of whether the entity's financial statements are presented in accordance with the applicable financial reporting framework. As a result, when the applicable financial reporting framework includes explicit requirements for management to evaluate the entity's ability to continue as a going concern in preparing interim financial information, the auditor is required to perform interim review procedures related to management's evaluation of the entity's ability to continue as a going concern and the adequacy of the related disclosures in the interim financial information.

[Issue Date: January 2015.]

4. Consideration of Financial Statements Effects

.09 *Question*—AU-C section 570 establishes requirements for the auditor to consider the possible effects on the financial statements and the adequacy of the related disclosure in situations when the auditor concludes there is substantial doubt or when concern about

⁶ Paragraph .05 of AU-C section 930, *Interim Financial Information* (AICPA, *Professional Standards*).

⁷ Paragraph .16 of AU-C section 930.

⁸ See footnote 7.

substantial doubt has been alleviated after consideration of management's plans.⁹ In addition, in assessing the adequacy of the disclosures, the related application guidance in AU-C section 570 provides examples of matters that management might disclose in the financial statements.¹⁰ How should an auditor apply this guidance when the applicable financial reporting framework contains disclosure requirements related to management's going concern evaluation?

.10 *Interpretation*—As noted in Auditing Interpretation No. 1, the auditor is required to form an opinion on whether the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.¹¹ As a result, when the applicable financial reporting framework provides disclosure requirements related to management's evaluation of substantial doubt, the auditor's assessment of the financial statement effects under AU-C section 570 would be based on the disclosure requirements of the applicable financial reporting framework.¹²

[Issue Date: January 2015.]

⁹ Paragraphs .12–.13 of AU-C section 570.

¹⁰ Paragraph .A4 of AU-C section 570.

¹¹ Paragraph .02 of Auditing Interpretation No. 1.

¹² Paragraphs .12–.13 and .A4 of AU-C section 570.