



## Agenda Item 1

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

#### Objective of Agenda Item

To approve for exposure a 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

- 1) AU-C section 580, *Written Representations*,
- 2) AU-C section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*,
- 3) AU-C section 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*, and
- 4) 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
- Ryan Kaye—E&Y
- Steve Morrison—Morrison, Brown, Argiz & Farra
- Chris Smith—BDO
- Michael Westervelt—CliftonLarson (TIC)

#### Issues for Discussion

##### *Auditor Reporting Issues*

At its January 2016 meeting, the ASB discussed options to address the uncertainty with respect to the work effort that would be required to apply AU-C 570 when the going concern basis of accounting is not applied or when it may not be inherently relevant with regards to special

purpose frameworks and audits of single financial statements and specific elements, accounts, or items of a financial statement, respectively. The ASB decided with the option to make amendments to AU-C 800 and AU-C 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 conclusion of whether there is substantial doubt about the entity's ability to continue as a going concern described in AU-C section 570.

The Task Force agreed that the auditor's responsibilities include an evaluation of whether disclosures are needed related to risk and uncertainties in achieving fair presentation in audits of special purpose frameworks and audits of single financial statements and specific elements, accounts, or items of a financial statement. Also the Task Force agreed, this evaluation should be performed without connecting the conclusion of whether there is substantial doubt about the entity's ability to continue as a going concern. The Task Force further agreed that special purpose frameworks may or may not be prepared in accordance with a financial reporting framework for which the going concern basis of accounting is relevant. If going concern basis of accounting is relevant then AU-C section 570 applies. However, upon reflection, the Task Force believes that for single financial statements and specific elements, accounts, or items of a financial statement, the going concern basis of accounting is not relevant. This is based on the premise that the evaluation and disclosure of whether the use of the going concern basis of accounting is relevant or whether there is substantial doubt about an entity's ability to continue as a going concern are matters to be considered at an enterprise level and not at the level of a single financial statement and specific elements, accounts, or items of a financial statement. This is consistent with extant AU-C section 570, which was silent in regards to single financial statements and specific elements, accounts, or items of a financial statement. In addition, the Task Force believes the issue of whether the going concern basis of accounting is relevant to single financial statements and specific elements, accounts, or items of a financial statement is more of an accounting issue.

The following summarizes the edits proposed by the Task Force.<sup>1</sup>

- 1) Removed from the proposed AU-C 570 all of the edits previously included to the application guidance relative to AU-C 800 and 805 (paragraphs A1-A4 of the previous version).
- 2) Included an additional sentence derived from ISA 570.2 to make it clear that audits of 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 relevant, e.g. cash basis of accounting. The revised paragraph reads as follows:
  3. A complete set of general purpose financial statements is prepared using the going concern basis of accounting, unless the liquidation basis of accounting is appropriate.  
***Audits of 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***

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<sup>1</sup> The proposed edits to AU-C 800 and 805 are shown as appendix B and C, respectively, to the proposed AU-C 570.

*relevant (for example, the going concern basis of accounting is not relevant for financial statements prepared on the cash basis of accounting).*

- 3) Included an application guidance paragraph (A2) referencing to AU-C 800 applicability of AU-C 570 and also the auditor's considerations of the disclosures related to risks and uncertainties in AU-C 800 and AU-C 805.
- 4) In AU-C 800, included an additional sentence at the end of paragraph 17 of AU-C 800 to highlight the auditor's responsibility to evaluate the risks and uncertainties disclosures in the financial statements. The revised paragraph reads as follows:

17. Section 700 requires the auditor to evaluate whether the financial statements achieve fair presentation. 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. ***In evaluating whether the financial statements achieve fair presentation, the auditor should evaluate whether the financial statements properly disclose the entity's risks and uncertainties related to financial reporting.***

- 5) In AU-C 800, added the following application guidance paragraphs:

A20a. As explained in the proposed AU-C Section 570, 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.

A20b. For audits of special purpose financial statements where the going concern basis of accounting is applicable, AU-C Section 570 applies.

A20c. Regardless if AU-C Section 570 applies, 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, the auditor may reference this emphasis-of-matter paragraph in the audit of a special purpose framework instead of repeating the emphasis-of-matter paragraph if the general purpose financial statements are available to the users of the special purpose financial statements. AU-C Section 810 provides an explanation with respect when financial statements are deemed to be available.

A20d. In evaluating whether the financial statements achieve fair presentation, the auditor is required to evaluate whether the financial statements properly disclose the entity's risks and uncertainties. As result, even if the special purpose financial statements 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 the entity has disclosed its risks and uncertainties related to financial reporting in order to achieve a fair presentation. The auditor may consider FASB ASC 275, *Risks and Uncertainties*, and ASC 450, *Contingencies*, as guidance of risk and uncertainties related to financial reporting. Certain of these uncertainties may not be applicable to the special purpose financial statements if it is related to a specific account or disclosure that is not part of the special purpose financial statements, for example, certain concentration disclosures.

Proposed paragraph A20c would provide application guidance that an auditor may make reference to an emphasis-of-matter paragraph in the special purpose framework auditor report instead of repeating the emphasis-of-matter paragraph in the general purpose financial statements if the general purpose financial statements are available to the users of the special purpose financial statements ***regardless if AU-C 570 section applies*** [emphasis added]. This notion is being proposed in the interest of convergence with the ISAs because the ISAs use this reporting model.

- 6) In AU-C 805, included a similar requirement as in AU-C 800 (see item 4 above) at the end of the requirement in paragraph 11.
- 7) In AU-C 805, added the following application guidance paragraph:

A11a. If in the general purpose financial statements, the auditor has included an emphasis-of-matter paragraph related to substantial doubt about the entity's ability to continue as a going concern and the general purpose financial statements are available to the users of the single financial statement or specific elements, accounts, or items of a financial statement, the auditor may reference this emphasis-of-matter paragraph in the audit of the single financial statement and specific elements, accounts, or items of a financial statement. AU-C Section 810 provides an explanation with respect when financial statements are deemed to be available.

A11b. In evaluating whether the single financial statements and specific elements, accounts, or items of a financial statement achieve fair presentation, the auditor is required to evaluate whether the single financial statements and specific elements, accounts, or items of a financial statement properly disclose the entity's risks and uncertainties. The auditor may consider FASB ASC 275, *Risks and Uncertainties*, and ASC 450, *Contingencies*, as guidance of risk and uncertainties related to financial reporting. Certain of these uncertainties may not be applicable to the single financial statements and specific elements, accounts, or items of a financial statement if it is related to a specific account or disclosure that is not part of these financial statements or the specific element, for example, certain concentration disclosures.

Similar to the proposed changes above (paragraph A20c of AU-C 800), paragraph A11a also allows for a reference to the emphasis-of-matter paragraph related to substantial doubt about an entity's to continue as a going concern in a general purpose financial statements. Similar to AU-C 800 this is in the spirit of convergence and even though the going concern basis of accounting is

not relevant for single financial statements and specific elements, accounts, or items of a financial statement (as discussed above), the information might be useful to the users of these financial statements.

### **Expected ASB Action**

1. Does the ASB agree with the revisions to the scope section and application guidance in AU-C 570?
2. What are the ASB's views about the requirement added and application guidance included in AU-C 800?
3. What are the ASB's views about the requirement added and application guidance included in AU-C 805? Specifically, does the ASB agree about staying silent on the issue whether the going concern basis of accounting is relevant to single financial statements and specific elements, accounts, or items of a financial statement? Also, what are the ASB's views in allowing for a reference to an emphasis-of-matter related to substantial doubt about an entity's ability to continue as a going concern in the general purpose financial statements when the going concern basis of accounting is not relevant for these financial statements?

### ***Interim Financial Information***

Task Force discussed an issue that the requirement in proposed paragraph 15a only addresses the requirement for the auditor to perform interim procedures related to whether substantial doubt exist in the interim financial information. The proposed requirement was inconsistent with the proposed AU-C 570 objectives to address 1) whether the use of the going concern basis is appropriate and 2) whether substantial doubt about the entity's ability to continue as a going concern exists. In response, the Task Force suggests amending the proposed paragraphs 15a and 16 to address both thresholds consistent with AU-C 570.

The revised paragraph 15a reads as follows:

**.15a** If the applicable financial reporting framework includes requirements for management to assess the entity's ability to continue as a going concern for a reasonable period of time in preparing interim financial information, the auditor should perform interim review procedures related to (a) whether the going concern basis of accounting is appropriate, (b) management's evaluation if there are conditions or events that raised substantial doubt about the entity's ability to continue as a going concern, (c) and the adequacy of the related disclosures in the interim financial information.

The revised paragraph 16 reads as follows:

.16 If the applicable financial reporting framework does not include a requirement for management to evaluate the entity's ability to continue as a going concern for a reasonable period time in preparing interim financial information

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- i. : if (a) conditions or events that may indicate substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time 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 raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, the auditor should:
- a. Inquire of management whether the going concern basis of accounting is appropriate,
  - b. Inquire of management about its plans for dealing with the adverse effects of the conditions or events, and (Ref: par. .A23)
  - c. Consider the adequacy of the disclosure about such matters in the interim financial information. (Ref: par. .A24)

The ASB instructed the Task Force to include application guidance to include an illustrative emphasis-of-matter paragraph if management has disclosed in the notes to the financial statements conditions or events that are identified but substantial doubt is alleviated or the financial reporting framework does not require a statement in the notes that substantial doubt exists.

The following is the Task Force's proposed application guidance included in the amendments to AU-C 930:

A48c. The auditor may include an emphasis-of-matter paragraph if management has disclosed the conditions or events in the notes to the financial statements but a statement related to substantial doubt is not required to be included. The following is an illustration of an emphasis-of-matter paragraph when no statement relating to substantial doubt is disclosed in the notes to the interim financial information but conditions or events are disclosed.

As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency. Management's plans in regards to these matters are also described in Note X.

**Expected ASB Action**

4. Does the ASB agree with the Task Force's recommendation to amend proposed paragraph 15a to address both thresholds 1) whether the going concern basis is appropriate and 2) whether substantial doubt about an entity's ability to continue as a going concern exists?

5. What are the ASB's views about the Task Force proposed application guidance to illustrate an emphasis-of-matter paragraph in the situation when disclosures identify conditions or events but a statement related to substantial doubt is not included?

### *Disclaimer of Opinion*

In January 2016, the ASB discussed whether to include an illustration of a disclaimer related to uncertainties. The ASB agreed not to include such an illustration because such situations are expected to be rare. The ASB suggested that the Task Force further look into whether the requirement and application guidance related to disclaimer of opinion included in the proposed AU-C 570 should be deleted. This is because certain members viewed the auditor's decision to disclaim an opinion is a matter of whether sufficient appropriate audit evidence has been obtained rather than a going concern consideration. Additionally, it was suggested for the Task Force to consider AU-C 705 (see paragraphs 10 and A13 and A14) to evaluate whether it addresses the issue of disclaimer related to uncertainties. The Task Force agrees AU-C 705 through the requirement and application guidance addresses uncertainties in a more holistic manner. As a result, the Task Force suggests deleting the following content dealing with disclaimer of opinion in AU-C 570.

27. Nothing in this proposed SAS precludes an auditor from disclaiming an opinion in cases involving uncertainties. When the auditor disclaims an opinion, the report should not include the going-concern emphasis-of-matter paragraph described in paragraph 24 of this proposed SAS but, rather, describe the substantive reasons for the auditor's disclaimer of opinion in the auditor's report as required by AU-C section 705. The auditor should consider the adequacy of disclosure of the uncertainties and their possible effects on the financial statements as described in paragraphs 21 and 22 of this proposed SAS even when disclaiming an opinion. (Ref: par. A48)

A43 (guidance to paragraph 25). Disclaiming an opinion, rather than expressing an opinion and including a going-concern emphasis-of-matter paragraph in the auditor's report, does not obviate the need for disclosure in the auditor's report of the matter giving rise to the disclaimer.

A48 (guidance to paragraph 27). In situations involving multiple 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 including the emphasis-of-matter paragraph required by paragraph 25. AU-C section 705 (Revised) provides guidance on this issue.

### **Expected ASB Action**

6. Does the ASB agree with removing the content dealing with disclaimer of opinion from the proposed AU-C 570?

## *Other Matters*

### *Written Representations<sup>2</sup>*

The ASB directed the Task Force to consider proposing an amendment to AU-C 580 to add a general written representation that would cover going concern. The following is the proposed edit to paragraph 10 of AU-C section 580.

#### Preparation and Fair Presentation of the Financial Statements

.10 The auditor should request management to provide a written representation that it has fulfilled its responsibility, as set out in the terms of the audit engagement,

- a. for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework;
- b. *for completing its evaluation related to whether there is substantial doubt about the entity's ability to continue as a going concern [when the financial reporting framework requires management to evaluate whether there is substantial doubt about the entity's ability to continue as a going concern], and***
- ~~c.~~ for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. fn 2 (Ref: par. .A7–.A10, .A22, and .A29)

The proposed edit is presented to be responsive to the direction provided by the ASB in January. However, upon further reflection, some members of the Task Force questioned the need of the proposed written representation. They believe that the assessment and evaluation of going concern is part of the written representation required under subparagraph 10a. They also questioned the need to specifically call out a going concern written representation among all of the other matters required under a financial reporting framework.

### *Audit Documentation*

At the January 2016 meeting, the ASB inquired about the disposition of paragraph 22 of extant AU-C 570, Documentation, which reads as follows:

- 22.** If the auditor believes, before consideration of management's plans pursuant to paragraph 10 of this SAS, there is substantial doubt about the ability of the entity to continue as a going concern for a reasonable period of time, the auditor should document the following:
- a. The conditions or events that led the auditor 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.

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<sup>2</sup> The proposed edits to AU-C 580 are shown in appendix A to the proposed AU-C 570.



- c. The audit procedures performed to evaluate the significant elements of management's plans and evidence obtained.
- 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 auditor's conclusion as to the need for, and, if applicable, the adequacy of, disclosure of the principal conditions or events that initially caused the auditor to believe there was substantial doubt.
- e. The auditor's conclusion with respect to the effects on the auditor's report.

In drafting proposed AU-C 570, the Task Force concluded that this documentation requirement is not considered necessary because the FASB standards now require management to make an evaluation of going concern and to include disclosures related to going concern. The auditor's responsibility is to obtain audit evidence about management's assessment and evaluate the adequacy of the financial statement disclosures. The Task Force acknowledges that in situations where financial reporting frameworks do not include the same requirements as the FASB standards, the requirements of AU-C 230, *Audit Documentation*, apply.

### *Terminology*

In drafting the proposed AU-C 570, a key consideration of the Task Force has been to align the terminology to the FASB's terminology, whenever possible. Paragraph A4 of the proposed AU-C section includes the definition of substantial doubt:

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 ...

A matter considered by the Task Force is whether in all situations where the proposed AU-C 570 refers to "the entity's ability to continue as a going concern exists when conditions and events," the phrase "considered in the aggregated" should be used in all circumstances. The Task Force believes that the term should not be included in all situations because the term as used by the FASB seems to refer to management's conclusion about whether substantial doubt exists rather than the identification of individual conditions or events that give rise to substantial doubt.

Accordingly, the Task Force proposes to include the term "considered in the aggregate" when referring to requirements in which the auditor makes a conclusion (for example, paragraph 21) and not when referring to requirements when the auditor identifies individual conditions or events (for example, paragraph 12).

### **Expected ASB Action**

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7. What are the views about the proposed edits to AU-C section 580 to include an additional representation addressing Going Concern?
8. Does that ASB agree with deleting from the proposed AU-C 570 the documentation requirement currently in extant AU-C 570?
9. What are the ASB's views about the use of the phrase "considered in the aggregate?"

**Items Presented**

Agenda Item 1 – Issues Paper

Agenda Item 1A – Proposed AU-C section 570\_marked from the January 2016 ASB meeting

Agenda Item 1B – Proposed conforming amendments to AU-C section 930\_marked from the January 2016 ASB meeting

Agenda Item 1C – AU-C 570\_Matrix (for reference purposes)

Agenda Item 1D – Wrap Document (for reference purposes to be updated based on discussions with the ASB discussion)

Mr. Panucci will refer to the Issues Paper and agenda items 1A and 1B in leading the discussion.