

## AU-C Section 570

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

Source: SAS No. 126.

See section 9570 for interpretations of this section.

Effective for audits of financial statements for periods ending on or after December 15, 2012.

## Introduction

### Scope of This Section

**.01** This section addresses the auditor's responsibilities in an audit of financial statements with respect to evaluating whether there is substantial doubt about the entity's ability to continue as a going concern. This section applies to all audits of financial statements, regardless of whether the financial statements are prepared in accordance with a general purpose or a special purpose framework.<sup>1</sup> This section does not apply to an audit of financial statements based on the assumption of liquidation (for example, when [a] an entity is in the process of liquidation, [b] the owners have decided to commence dissolution or liquidation, or [c] legal proceedings, including bankruptcy, have reached a point at which dissolution or liquidation is probable).<sup>2</sup>

**.02** Continuation of an entity as a going concern is assumed in financial reporting in the absence of significant information to the contrary. Ordinarily, information that significantly contradicts the going concern assumption relates to the entity's inability to continue to meet its obligations as they become due without substantial disposition of assets outside the ordinary course of business, restructuring of debt, externally forced revisions of its operations, or similar actions.

### The Auditor's Responsibility

**.03** The auditor's responsibility is to evaluate whether there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. The auditor's evaluation is based on the auditor's knowledge of relevant conditions or events that exist at, or have occurred prior to, the date of the auditor's report. Information about such conditions or events is obtained from the application of audit procedures planned and performed to achieve audit objectives that are related to management's assertions embodied in the financial statements being audited, as described in section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

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<sup>1</sup> *General purpose* and *special purpose frameworks* are defined in section 700, *Forming an Opinion and Reporting on Financial Statements*, and section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, respectively.

<sup>2</sup> See Interpretation No. 1, "Reporting on Financial Statements Prepared on a Liquidation Basis of Accounting," of section 700, (sec. 9700 par. .01–.05).

.04 As described in section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are particularly significant for future conditions or events that may cause an entity to cease to continue as a going concern. The auditor cannot predict such future conditions or events. The fact that the entity may cease to exist as a going concern subsequent to receiving a report from the auditor that does not refer to the auditor having substantial doubt, even within one year following the date of the financial statements, does not, in itself, indicate inadequate performance by the auditor. Accordingly, the absence of any reference to substantial doubt in an auditor's report cannot be viewed as a guarantee as to the entity's ability to continue as a going concern.

## Effective Date

.05 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

## Objectives

.06 The objectives of the auditor are to

- a. evaluate and conclude, based on the audit evidence obtained, whether there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time;
- b. assess the possible financial statement effects, including the adequacy of disclosure regarding uncertainties about the entity's ability to continue as a going concern for a reasonable period of time; and
- c. determine the implications for the auditor's report.

## Definition

.07 For purposes of this section, the following term has the meaning attributed as follows:

**Reasonable period of time.** A period of time not to exceed one year beyond the date of the financial statements being audited.

## Requirements

### Evaluating Whether Substantial Doubt Exists

.08 The auditor should evaluate whether there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time based on the results of the audit procedures performed pursuant to paragraphs .09-.11 and .14.

### ***Identifying Conditions or Events That Indicate Substantial Doubt Could Exist (Ref: par. .A1-.A2)***

.09 The auditor should consider whether the results of the procedures performed during the course of the audit identify conditions or events that, when considered in the aggregate, indicate there could be substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time.

The auditor should consider the need to obtain additional information about such conditions or events, as well as the appropriate audit evidence to support information that mitigates the auditor's doubt.

### ***Consideration of Management's Plans When the Auditor Believes There Is Substantial Doubt***

**.10** If, after considering the identified conditions or events in the aggregate, the auditor believes there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, the auditor should obtain information about management's plans that are intended to mitigate the adverse effects of such conditions or events. The auditor should

- a. assess whether it is likely that the adverse effects would be mitigated by management's plans for a reasonable period of time;
- b. identify those elements of management's plans that are particularly significant to overcoming the adverse effects of the conditions or events and plan and perform procedures to obtain audit evidence about them, including, when applicable, considering the adequacy of support regarding the ability to obtain additional financing or the planned disposal of assets; and
- c. assess whether it is likely that such plans can be effectively implemented. (Ref: par. .A3)

**.11** When prospective financial information is particularly significant to management's plans, the auditor should request management to provide that information and should consider the adequacy of support for significant assumptions underlying that information. The auditor should give particular attention to assumptions that are

- material to the prospective financial information.
- especially sensitive or susceptible to change.
- inconsistent with historical trends.

The auditor's consideration should be based on knowledge of the entity, its business, and its management and should include (a) reading the prospective financial information and the underlying assumptions and (b) comparing prospective financial information from prior periods with actual results and comparing prospective information for the current period with results achieved to date. If the auditor becomes aware of factors, the effects of which are not reflected in such prospective financial information, the auditor should discuss those factors with management and, if necessary, request revision of the prospective financial information.

### ***Consideration of Financial Statement Effects (Ref: par. .A4)***

**.12** When, after considering management's plans, the auditor concludes there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, the auditor should consider the possible effects on the financial statements and the adequacy of the related disclosure.

**.13** When the auditor concludes, primarily because of the auditor's consideration of management's plans, that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time has been alleviated, the auditor should consider the need for, and evaluate the adequacy of, disclosure of the principal conditions or events that initially caused the auditor

to believe there was substantial doubt. The auditor's consideration of disclosure should include the possible effects of such conditions or events, and any mitigating factors, including management's plans.

### Written Representations (Ref: par. .A5)

.14 If the auditor believes, before consideration of management's plans pursuant to paragraph .10, there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, the auditor should obtain written representations from management

- a. regarding its plans that are intended to mitigate the adverse effects of conditions or events that indicate there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time and the likelihood that those plans can be effectively implemented, and
- b. that the financial statements disclose all the matters of which management is aware that are relevant to the entity's ability to continue as a going concern, including principal conditions or events and management's plans.

### Consideration of the Effects on the Auditor's Report (Ref: par. .A6–.A8)

.15 If, after considering identified conditions or events and management's plans, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains, the auditor should include an emphasis-of-matter paragraph<sup>3</sup> in the auditor's report to reflect that conclusion.

.16 The auditor's conclusion about the entity's ability to continue as a going concern should be expressed through the use of the phrase "substantial doubt about its (the entity's) ability to continue as a going concern" or similar wording that includes the terms *substantial doubt* and *going concern*. In a going-concern emphasis-of-matter paragraph, the auditor should not use conditional language in expressing a conclusion concerning the existence of substantial doubt about the entity's ability to continue as a going concern.

.17 If the auditor concludes that the entity's disclosures with respect to the entity's ability to continue as a going concern for a reasonable period of time are inadequate, the auditor should modify the opinion in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

.18 Nothing in this section 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 .15 of this section but, rather, describe the substantive reasons for the auditor's disclaimer of opinion in the auditor's report as required by section 705.<sup>4</sup> The auditor should consider the adequacy of disclosure of the uncertainties and their possible effects on the financial statements as described in paragraph .12 of this section even when disclaiming an opinion.

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<sup>3</sup> Paragraphs .06–.07 of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*, address requirements concerning emphasis-of-matter paragraphs.

<sup>4</sup> Paragraph .17 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

## Communication With Those Charged With Governance

.19 If, after considering identified conditions or events in the aggregate and after considering management's plans, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains, the auditor should communicate the following to those charged with governance:

- a. The nature of the conditions or events identified
- b. The possible effect on the financial statements and the adequacy of related disclosures in the financial statements
- c. The effects on the auditor's report

## Comparative Presentations

.20 If substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time existed at the date of prior period financial statements that are presented on a comparative basis, and that doubt has been removed in the current period, the going-concern emphasis-of-matter paragraph included in the auditor's report on the financial statements of the prior period should not be repeated. (Ref: par. .A9)

## Eliminating a Going-Concern Emphasis-of-Matter Paragraph From a Reissued Report (Ref: par. .A10–.A11)

.21 The auditor may be requested to reissue an auditor's report and eliminate a going-concern emphasis-of-matter paragraph contained therein. Although an auditor has no obligation to reissue the report, if the auditor decides to reissue the report, the auditor should reassess the going-concern status of the entity by

- a. performing audit procedures related to the event or transaction that prompted the request to reissue the report without the going-concern emphasis-of-matter paragraph.
- b. performing the procedures listed in section 560, *Subsequent Events and Subsequently Discovered Facts*, at or near the date of reissuance.<sup>5</sup>
- c. considering the matters described in paragraphs .09–.11 and .14 of this section based on the conditions or circumstances at the date of reissuance.
- d. considering the implications for the auditor's report in accordance with section 560.<sup>6</sup>

## Documentation

.22 If the auditor believes, before consideration of management's plans pursuant to paragraph .10, 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.

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<sup>5</sup> Paragraphs .09–.10 of section 560, *Subsequent Events and Subsequently Discovered Facts*.

<sup>6</sup> Paragraph .13 of section 560.

- 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.
- 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.

## Application and Other Explanatory Material

### Evaluating Whether Substantial Doubt Exists

#### ***Identifying Conditions or Events That Indicate Substantial Doubt Could Exist (Ref: par. .09)***

**.A1** It is not necessary to design audit procedures solely to identify conditions or events that, when considered in the aggregate, indicate there could be substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. The results of audit procedures designed and performed to identify and assess risk in accordance with section 315, gather audit evidence in response to assessed risks in accordance with section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, and complete the audit are expected to be sufficient for that purpose. The following are examples of procedures that may identify such conditions or events:

- Analytical procedures
- Review of subsequent events
- Review of compliance with the terms of debt and loan agreements
- Reading of minutes of meetings of stockholders, board of directors, and important committees of the board
- Inquiry of an entity's legal counsel about litigation, claims, and assessments
- Confirmation with related and third parties of the details of arrangements to provide or maintain financial support

**.A2** In performing audit procedures such as those described in paragraph .A1, the auditor may identify information about certain conditions or events that, when considered in the aggregate, indicate there could be substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. The significance of such conditions or events will depend on

the circumstances, and some conditions or events may have significance only when viewed in conjunction with others. The following are examples of such conditions or events:

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

### **Consideration of Management's Plans When the Auditor Believes There Is Substantial Doubt (Ref: par. .10)**

.A3 The auditor's considerations relating to management's plans may include the following:

- Plans to dispose of assets
  - Restrictions on disposal of assets, such as covenants limiting such transactions in loan or similar agreements or encumbrances against assets
  - Apparent marketability of assets that management plans to sell
  - Possible direct or indirect effects of disposal of assets
- Plans to borrow money or restructure debt
  - Availability of debt financing, including existing or committed credit arrangements, such as lines of credit or arrangements for factoring receivables or sale-leaseback of assets
  - Existing or committed arrangements to restructure or subordinate debt or to guarantee loans to the entity
  - Possible effects on management's borrowing plans of existing restrictions on additional borrowing or the sufficiency of available collateral
- Plans to reduce or delay expenditures
  - Apparent feasibility of plans to reduce overhead or administrative expenditures, to postpone maintenance or research and development projects, or to lease rather than purchase assets

- Possible direct or indirect effects of reduced or delayed expenditures
- Plans to increase ownership equity
  - Apparent feasibility of plans to increase ownership equity, including existing or committed arrangements to raise additional capital
  - Existing or committed arrangements to reduce current dividend requirements or to accelerate cash distributions from affiliates or other investors

### Consideration of Financial Statement Effects (Ref: par. .12–.13)

**.A4** In considering the adequacy of disclosure, some of the information that might be disclosed includes the following:

- Principal conditions or events giving rise to the assessment of substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time
- The possible effects of such conditions or events
- Management's evaluation of the significance of those conditions or events and any mitigating factors
- Possible discontinuance of operations
- Management's plans (including relevant prospective financial information)
- Information about the recoverability or classification of recorded asset amounts or the amounts or classification of liabilities

### Written Representations (Ref: par. .14)

**.A5** If the auditor determines that it is necessary to obtain one or more representations with respect to identified conditions or events that indicate there could be substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time pursuant to paragraph .09, section 580, *Written Representations*, applies.<sup>7</sup>

### Consideration of the Effects on the Auditor's Report (Ref: par. .15–.18)

**.A6** The inclusion of a going-concern emphasis-of-matter paragraph in the auditor's report is sufficient to inform the users of the financial statements that substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time. The following is an illustration of a going-concern emphasis-of-matter paragraph when the auditor concludes that there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time:

Emphasis of Matter Regarding Going Concern

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

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<sup>7</sup> Paragraph .19 of AU-C section 580, *Written Representations*.



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.

**.A7** Examples of conditional language that is inappropriate to use in the emphasis-of-matter paragraph include the following:

- "If the Company continues to suffer recurring losses from operations and continues to have a net capital deficiency, there may be substantial doubt about its ability to continue as a going concern."
- "The Company has been unable to renegotiate its expiring credit agreements. Unless the Company is able to obtain financial support, there is substantial doubt about its ability to continue as a going concern."

**.A8** 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.

### **Comparative Presentations (Ref: par. .20)**

**.A9** Substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time that arose in the current period does not imply that a basis for such doubt existed in the prior period and, therefore, does not affect the auditor's report on the financial statements of the prior period that are presented on a comparative basis. section 700, *Forming an Opinion and Reporting on Financial Statements*, provides guidance on reporting when financial statements of one or more prior periods are presented on a comparative basis with financial statements of the current period.

### **Eliminating a Going-Concern Emphasis-of-Matter Paragraph From a Reissued Report (Ref: par. .21)**

**.A10** After the auditor has issued the auditor's report containing a going-concern emphasis-of-matter paragraph, the auditor may be asked to reissue the auditor's report on the financial statements and eliminate the going-concern emphasis-of-matter paragraph that appeared in the original report. Such requests ordinarily occur after the conditions or events that gave rise to substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time have been resolved. For example, subsequent to the date of the auditor's original report, an entity might obtain needed financing.

**.A11** The auditor may perform procedures in addition to those required by paragraph .21 that the auditor deems necessary in the circumstances when reassessing the entity's ability to continue as a going concern for a reasonable period of time.