

**AU-C Section 9570*****The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern: Auditing Interpretations of 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 section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, 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**—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, 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.<sup>1</sup> In applying 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**—Section 700, *Forming an Opinion and Reporting on Financial Statements*, 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.<sup>2</sup> 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 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.

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<sup>1</sup> Paragraph .08 of section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.

<sup>2</sup> Paragraph .13 of section 700, *Forming an Opinion and Reporting on Financial Statements*.

## 2. Definition of Reasonable Period of Time

**.03 Question**—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.<sup>3</sup> 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."<sup>4</sup> 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 Interpretation No. 1, "Definition of *Substantial Doubt About an Entity's Ability to Continue as a Going Concern*" (par. .01–.02), 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.<sup>5</sup> 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.

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## 3. Interim Financial Information

**.06 Question**—Section 930, *Interim Financial Information*, 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 procedures.<sup>6</sup> Section 930 addresses the auditor's responsibility about when to make an inquiry concerning an entity's ability to continue as a going concern.<sup>7</sup>

**.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

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<sup>3</sup> Paragraph .08 of section 570.

<sup>4</sup> Paragraph .07 of section 570.

<sup>5</sup> Paragraph .02 of Interpretation No. 1, "Definition of *Substantial Doubt About an Entity's Ability to Continue as a Going Concern*" (par. .01–.02).

<sup>6</sup> Paragraph .05 of section 930, *Interim Financial Information*.

<sup>7</sup> Paragraph .16 of section 930.

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 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.<sup>8</sup>

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.

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## 4. Consideration of Financial Statements Effects

**.09 Question**—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 substantial doubt has been alleviated after consideration of management's plans.<sup>9</sup> In addition, in assessing the adequacy of the disclosures, the related application guidance in section 570 provides examples of matters that management might disclose in the financial statements.<sup>10</sup> 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 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.<sup>11</sup> As a result, when the applicable financial reporting framework provides disclosure requirements related to management's evalua-

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<sup>8</sup> See footnote 7.

<sup>9</sup> Paragraphs .12–.13 of section 570.

<sup>10</sup> Paragraph .A4 of section 570.

<sup>11</sup> Paragraph .02 of Interpretation No. 1.

tion of substantial doubt, the auditor's assessment of the financial statement effects under section 570 would be based on the disclosure requirements of the applicable financial reporting framework.<sup>12</sup>

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<sup>12</sup> Paragraphs .12-.13 and .A4 of section 570.