

Explanatory Memorandum – Statement on Auditing Standards No. 132

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



In February 2017, the AICPA’s Auditing Standards Board (ASB) issued Statement on Auditing Standards (SAS) No. 132, *The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern* (AICPA, *Professional Standards*, AU-C sec. 570).

SAS No. 132 supersedes SAS No. 126 of the same title and will be effective for (i) audits of financial statements for periods ending on or after December 15, 2017, and (ii) reviews of interim financial information for interim periods beginning after fiscal years ending on or after December 15, 2017.

The primary objective in the development of SAS No. 132 was to consider the accounting provisions of 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 Statement No. 56).

Background

SAS No. 126 was issued by the ASB in June 2012 to apply the clarity drafting conventions to, and supersede, SAS No. 59 of the same title, as amended. The project to redraft SAS No. 59, as amended, was undertaken as part of the ASB’s Clarity Project.

At the time SAS No. 126 was issued, FASB standards did not address management’s responsibilities for evaluation of substantial doubt about an entity’s ability to continue as a going concern. However, FASB was contemplating the development of an accounting standard addressing going concern. As a result, SAS No. 126 clarified SAS No. 59, as amended, but did not converge with the International Auditing and Assurance Standards Board’s (IAASB) International Standard on Auditing (ISA) 570 (Revised), *Going Concern* (ISA 570 Revised), which was subsequently issued in January 2015. In August 2014, FASB issued ASU No. 2014-15, which is effective for annual periods ending after December 15, 2016, and for interim periods thereafter.

Additionally, GASB Statement No. 56 establishes guidance related to management’s responsibilities for assessing going concern for governmental entities.

In January 2015, the IAASB issued its revised auditor reporting standards which, among other things, included revisions to ISA 570 (Revised). The IAASB's auditor reporting standards, including ISA 570 (Revised), are effective for audits of financial statements for periods ending on or after December 15, 2016.

Also in January 2015, the ASB issued four new auditing interpretations to SAS No. 126. The issuance of these interpretations represented a short-term ASB initiative to provide interpretative guidance:

- a. Interpretation No. 1, "Definition of Substantial Doubt About an Entity's Ability to Continue as a Going Concern"
- b. Interpretation No. 2, "Definition of Reasonable Period of Time"
- c. Interpretation No. 3, "Interim Financial Information"
- d. Interpretation No. 4, "Consideration of Financial Statements Effects"

In July 2016, the ASB released Exposure Draft, *Proposed Statement on Auditing Standards, The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, to supersede SAS No. 126. Overall, responders to the exposure draft were supportive of the ASB's proposal to update SAS No. 126 in light of the impending effective date of FASB ASU No. 2014-15, using ISA 570 (Revised) as the base, and writing the proposed SAS in a neutral accounting framework manner.

Convergence

It is the ASB's strategy to converge its standards with those of the IAASB. Accordingly, in developing SAS No. 132, the ASB used ISA 570 (Revised) as the base. However, SAS No. 132 does not reflect any revisions to ISA 570 (Revised) related to the convergence with the IAASB's other auditor reporting standards. Those revisions will be contemplated as part of the ASB's overall auditor's report project, which is ongoing.

SAS No. 132 is intended to be applicable to audits of financial statements prepared under different financial accounting frameworks and, accordingly, was written in a neutral accounting framework manner. However, in discussing certain concepts, reference to certain accounting terms is necessary. To better explain and illustrate those concepts, the ASB used terminology that is more commonly used in the United States, such as terminology from the FASB standards and GASB statements.

Changes From Existing Standards

The ASB retained several concepts from SAS No. 126 including a requirement for the auditor to make a separate conclusion with respect to the existence of substantial doubt among other matters. The ASB believes the following are the most significant changes to the existing auditing standards resulting from the issuance SAS No. 132.

Auditor's Objectives and Related Conclusions

SAS No. 132 clarifies that the auditor's objectives include separate determinations and conclusions with respect to (1) the use of the going concern basis of accounting, when relevant, in the preparation of the financial statements, and (2) based on the audit evidence obtained whether substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time exists.

Financial Support by Third Parties or the Entity's Owner-Manager

SAS No. 132 includes a new requirement with respect to financial support by third-parties or the entities' owner-manager. In circumstances when management's plans include financial support by third parties or the entity's owner-manager and such evidence is necessary in supporting management's assertions about the entity's ability to continue as a going concern for a reasonable period of time, the auditor is required to obtain sufficient appropriate audit evidence about the intent and ability of such parties to provide the necessary financial support.

The application material of SAS No. 132 explains that the intent to provide the necessary financial support may be evidenced by either a) obtaining from management written evidence about the third party commitment or b) confirming directly with the supporting party. The application material further explains that when the financial support is provided by an owner-manager, the evidence

regarding intent may be in the form of a support letter or a written representation. Finally, the application material provides illustrative wording of a third party support letter.

Period Beyond Management's Assessment

SAS No. 132 includes a requirement for the auditor to inquire of management regarding its knowledge of conditions or events beyond the period of management's evaluation that may have an effect on the entity's ability to continue as a going concern. The inquiries are not intended to require management to extend its evaluation period but may affect other disclosure requirements or consideration of whether the financial statements are fairly presented.

Use of Emphasis Paragraphs When Substantial Doubt is Alleviated

The ASB includes application material in SAS No. 132 should an auditor decide to include an emphasis paragraph to highlight the liquidity issues related to management disclosures when the auditor concludes that substantial doubt has been alleviated by management's plans. An example of the emphasis paragraph in those circumstances is provided as application material.

Interim Financial Information

In issuing SAS No. 132, the ASB also amends AU-C section 930, *Interim Financial Information (AICPA, Professional Standards)*. Under extant AU-C section 930, the auditor is required to perform inquiries and consider the adequacy of disclosures to address the issue of substantial doubt about the entity's ability to continue as a going concern 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 the 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 inability to continue as a going concern. From the review report perspective, AU-C section 930 provides the auditor an option to include an emphasis-of-matter paragraph when management's disclosures are adequate.

The ASB decided to require performing review procedures to address the situations when the applicable financial reporting framework includes requirements for management to evaluate the entity's ability to continue as a going concern for a reasonable period of time in preparing interim financial information. The amendments to AU-C section 930 reflects a new requirement for the auditor to include an emphasis-of-matter paragraph in the review report when certain conditions or events exist related to substantial doubt about an entity's ability to continue as a going concern. This decision was based on the ASB's desire to achieve consistency in auditor reporting in both the annual audit and interim financial information.

Financial Statements Prepared in Accordance With a Special Purpose Framework

In the scope section, SAS No. 132 makes it clearer that the issues of going concern basis of accounting and whether substantial doubt exists are separate issues. As a result, when the going concern basis of accounting is not relevant, the requirement of SAS No. 132 to obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting do not apply. However, irrespective of whether the going concern basis of accounting is relevant in the preparation of special purpose financial statements, the requirements of SAS No. 132 apply regarding the auditor's responsibilities to conclude, based on the audit evidence obtained, whether substantial doubt exists and to evaluate the possible financial statement effects.

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