EXPOSURE DRAFT

Proposed Accounting Standards Update

Issued: June 26, 2013
Comments Due: September 24, 2013

Presentation of Financial Statements (Topic 205)

Disclosure of Uncertainties about an Entity's Going Concern Presumption

This Exposure Draft of a proposed Accounting Standards Update of Topic 205 is issued by the Board for public comment. Comments can be provided using the electronic feedback form available on the FASB website. Written comments should be addressed to:

Technical Director
File Reference No. 2013-300

Financial Accounting Standards Board
of the Financial Accounting Foundation

The *FASB Accounting Standards Codification*® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of U.S. GAAP understand how and why U.S. GAAP is changing and when the changes will be effective.

Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites comments on all matters in this Exposure Draft and is requesting comments by September 24, 2013. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at Exposure Documents Open for Comment
- Emailing a written letter to director@fasb.org, File Reference No. 2013-300
- Sending written comments to "Technical Director, File Reference No. 2013-300, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

Do not send responses by fax.

All comments received are part of the FASB's public file. The FASB will make all comments publicly available by posting them to the online public reference room portion of its website.

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Financial Accounting Standards Board
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Summary and Questions for Respondents

Why Is the FASB Issuing This Proposed Accounting Standards Update (Update)?

Under U.S. generally accepted accounting principles (GAAP), financial statements are prepared under the inherent presumption that the reporting entity will be able to continue as a going concern; that is, the entity will continue to operate such that it will be able to realize its assets and meet its obligations in the ordinary course of business (the going concern presumption). The going concern presumption is critical to financial reporting because it establishes the fundamental basis for measuring and classifying assets and liabilities.

Financial statements are prepared under the going concern presumption unless and until an entity's liquidation is imminent. When liquidation is imminent, an entity starts applying the liquidation basis of accounting as described in Subtopic 205-30, Presentation of Financial Statements—Liquidation Basis of Accounting.

Even before an entity's liquidation is imminent, there may be uncertainties about an entity's ability to continue as a going concern and, therefore, about its going concern presumption (going concern uncertainties). Currently, there is no guidance in U.S. GAAP about management's responsibilities in evaluating or disclosing going concern uncertainties. There also is no guidance in U.S. GAAP about when and how going concern uncertainties should be disclosed in an entity's financial statement footnotes. U.S. auditing standards and federal securities laws require that an auditor evaluate whether there is substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. Auditing standards also require auditors to assess the possible financial statement effects, including the adequacy of disclosures on uncertainties about the entity's ability to continue as a going concern for a reasonable period of time (the American Institute of Certified Public Accountant's Codification of Statements on Auditing Standards Section AU-C 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, or the Public Company Accounting Oversight Board's AU Section 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*).

The Board received input indicating that the lack of guidance in U.S. GAAP and the varying interpretations of when and how going concern uncertainties should be disclosed under the auditing standards result in diversity in the timing, nature, and extent of existing footnote disclosures. The proposed amendments in this Update are intended to provide preparers with guidance in U.S. GAAP about management's responsibilities for evaluating and disclosing going concern uncertainties and, thereby, reduce existing diversity in footnote disclosures. In doing so, the Board believes that the proposed amendments also would improve

the timeliness and the quality of footnote disclosures about going concern uncertainties.

Who Would Be Affected by the Amendments in This Proposed Update?

The proposed guidance on determining whether footnote disclosures are necessary and the guidance on the nature and extent of disclosures would apply to all entities. Additionally, an entity that is a Securities and Exchange Commission (SEC) filer would be required to evaluate and determine whether there is substantial doubt about its ability to continue as a going concern (going concern presumption). If there is substantial doubt, the SEC filer would disclose that determination in its financial statement footnotes.

What Are the Main Provisions?

The proposed amendments would provide guidance in U.S. GAAP about management's responsibilities in evaluating an entity's going concern uncertainties, and about the timing and content of related footnote disclosures. An entity would evaluate going concern uncertainties by assessing the likelihood that the entity would be unable to meet its obligations as they become due within 24 months after the financial statement date.

An entity would evaluate going concern uncertainties at each annual and interim reporting period and start providing footnote disclosures when it is either (1) *more likely than not* that the entity will be unable to meet its obligations within 12 months after the financial statement date without taking actions outside the ordinary course of business or (2) *known or probable* that the entity will be unable to meet its obligations within 24 months after the financial statement date without taking actions outside the ordinary course of business. In determining whether disclosures are necessary, an entity would assess information about conditions and events that exist at the date the financial statements are issued (or for a nonpublic entity the date that the financial statements are available to be issued). Mitigating conditions and events also would be considered. In determining whether disclosures are necessary, however, an entity would not consider the potential mitigating effect of management's plans that are outside the ordinary course of business.

When the above disclosure threshold is met, an entity would disclose in the footnotes a description of (1) the principal conditions and events that give rise to the entity's potential inability to meet its obligations, (2) the possible effects those conditions and events could have on the entity, (3) management's evaluation of the significance of those conditions and events, (4) mitigating conditions and events, and (5) management's plans that are intended to address the entity's

potential inability to meet its obligations. Disclosures may be less extensive in the early stages because available information may be limited. In subsequent reporting periods, disclosures may, depending on the circumstances, become more extensive as additional information becomes available about the conditions and events and about management's plans.

Additionally, the proposed amendments would require an entity that is an SEC filer to evaluate whether there is substantial doubt about its going concern presumption. If there is substantial doubt, the entity would disclose that determination in the footnotes. Substantial doubt would exist if, after assessing existing conditions and events and after considering all of management's plans (including those outside the ordinary course of business), the entity concludes that it is known or probable that it will be unable to meet its obligations within 24 months after the financial statement date. An entity that is not an SEC filer would not be required to evaluate or disclose whether there is substantial doubt about its going concern presumption but would be required to apply all of the other disclosure requirements within the proposed amendments.

How Would the Main Provisions Differ from Current U.S. Generally Accepted Accounting Principles (GAAP) and Why Would They Be an Improvement?

Currently, there is no guidance in U.S. GAAP about management's responsibilities in evaluating or disclosing going concern uncertainties. There is also no guidance in U.S. GAAP about when and how going concern uncertainties should be disclosed in an entity's financial statement footnotes. The proposed amendments are intended to provide preparers with guidance on management's responsibilities and disclosures about going concern uncertainties and, thereby, reduce existing diversity. In doing so, the Board believes that the proposed amendments also would improve the timeliness and the quality of footnote disclosures about going concern uncertainties.

The proposed amendments would improve and incorporate into U.S. GAAP many of the principles that are currently in the auditing standards by (1) requiring management to evaluate going concern uncertainties at each annual and interim reporting period, (2) prescribing a threshold and related guidance for starting disclosures, (3) requiring a 24-month assessment period after the financial statement date, and (4) providing a threshold for SEC filers to determine whether there is substantial doubt about an entity's going concern presumption.

Currently, the SEC's disclosure rules require that an SEC registrant disclose in its management's discussion and analysis (MD&A) information about trends and uncertainties that are reasonably likely to have a material effect on the registrant's liquidity, capital resources, and results of operations (Regulation S-K, Item 303(a)). Additionally, the SEC's regulations mandate disclosures about a

registrant's most significant risk factors (Regulation S-K, Item 503(c)). The information disclosed in the MD&A and the disclosure of risk factors can help users in their evaluation of going concern uncertainties. Therefore, the proposed amendments would not present new or incremental information in an SEC registrant's filing as a whole. However, the proposed amendments would provide SEC registrants with guidance in U.S. GAAP about the timing and content of footnote disclosures specific to going concern uncertainties. The Board believes that the introduction of this guidance would reduce diversity in the timing, nature, and extent of footnote disclosures and, in doing so, improve their timeliness and quality.

Entities that are not SEC registrants are not subject to the SEC's disclosure requirements, and their financial statements generally are limited to the core financial statements and the related footnotes. The Board received input indicating that the lack of guidance in U.S. GAAP and the varying interpretations of when and how going concern uncertainties should be disclosed result in diversity in the timing, nature, and extent of existing footnote disclosures provided by these entities about going concern uncertainties. The proposed amendments also would provide entities that are not SEC registrants with guidance and, thereby, reduce existing diversity. The proposed amendments also would lead to entities that are not SEC registrants providing more timely and more descriptive disclosures about going concern uncertainties than under current practice, which the Board believes would be beneficial to users of those financial statements.

When Would the Amendments Be Effective?

The effective date will be determined after the Board considers the feedback on the amendments in this proposed Update. The proposed amendments would apply prospectively for reporting periods after the effective date.

How Do the Proposed Provisions Compare with International Financial Reporting Standards (IFRS)?

There is guidance in IFRS that addresses the preparation of financial statements as a going concern and disclosures when there is a material uncertainty about an entity's ability to continue as a going concern. The International Accounting Standards Board currently is in the process of clarifying those disclosure requirements as part of a narrow implementation project. The proposed amendments to U.S. GAAP and current IFRS both emphasize that management is responsible for evaluating uncertainties about an entity's ability to continue as a going concern and for providing disclosures of those uncertainties. However, the proposed amendments have important differences.

Under IFRS, financial statements are prepared on a going concern basis "unless management either intends to liquidate the entity or to cease trading [operations], or has no realistic alternative but to do so" (paragraph 25 of IAS 1, *Presentation of Financial Statements*). When an entity does not prepare its financial statements on a going concern basis, IFRS requires that the entity disclose the basis of preparation used. IFRS does not provide guidance on the liquidation basis of accounting. Under U.S. GAAP, an entity uses the going concern presumption until liquidation is imminent, that is, when the liquidation basis of accounting is applied as described in Subtopic 205-30.

There is a single threshold under IFRS for disclosures of going concern uncertainties. Disclosures start when management is aware of material uncertainties related to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern. IFRS does not define the term *material uncertainty* or *significant doubt*. Under the proposed amendments to U.S. GAAP, there are two thresholds—one threshold for all entities that indicates the start of disclosures about going concern uncertainties and an additional threshold for SEC filers that indicates there is substantial doubt about an entity's going concern presumption.

Finally, under IFRS, the consideration period is at least 12 months from the financial statement date with no upper time limit. Under the proposed amendments to U.S. GAAP, the consideration period would not exceed 24 months after the financial statement date.

Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

Overall

Question 1: The proposed amendments would define *going concern presumption* as the inherent presumption in preparing financial statements under U.S. GAAP that an entity will continue to operate such that it will be able to realize its assets and meet its obligations in the ordinary course of business. Do you agree with this definition? If not, what definition should be used and why?

Question 2: Currently, auditors are responsible under the auditing standards for assessing going concern uncertainties and for assessing the adequacy of related disclosures. However, there is no guidance in U.S. GAAP for preparers as it

relates to management's responsibilities. Should management be responsible for assessing and providing footnote disclosures about going concern uncertainties? If so, do you agree that guidance should be provided in U.S. GAAP about the timing, nature, and extent of footnote disclosures about going concern uncertainties for SEC registrants and other entities? Why or why not?

Question 3: Would the proposed amendments reduce diversity in the timing, nature, and extent of footnote disclosures and provide relevant information to financial statement users? If so, would the proposed disclosures for SEC registrants provide users with incremental benefits relative to the information currently provided under other sections of U.S. GAAP and under the SEC's disclosure requirements?

Question 4: The proposed amendments would require management to evaluate going concern uncertainties and additionally, for SEC filers, to evaluate whether there is substantial doubt about the entity's ability to continue as a going concern. An alternative view is that such evaluations should not be required because management would inherently be biased and, thus, the resulting disclosures would provide little incremental benefit to investors. Do you believe that an entity's management has the objectivity to assess and provide disclosures of uncertainties about the entity's ability to continue as a going concern? Why or why not? If not, please also explain how this assessment differs from other assessments that management is required to make in the preparation of an entity's financial statements.

Question 5: At each reporting period, including interim periods, the proposed amendments would require management to evaluate an entity's going concern uncertainties. Do you agree with the proposed frequency of the assessment? If not, how often should the assessment be performed?

Question 6: For SEC registrants, the proposed footnote disclosures would include aspects of reporting that overlap with certain SEC disclosure requirements (including those related to risk factors and MD&A, among others). The Board believes that the proposed footnote disclosures would have a narrower focus on going concern uncertainties compared with the SEC's disclosure requirements. Do you agree? Why or why not? What differences, if any, will exist between the information provided in the proposed footnote disclosures and the disclosures required by the SEC? Is the redundancy that would result from this proposal appropriate? Why or why not?

Question 7: For SEC registrants, would the proposed footnote disclosure requirements about going concern uncertainties have an effect on the timing, content, or communicative value of related disclosures about matters affecting an entity's going concern assessment in other parts of its public filings with the SEC (such as risk factors and MD&A)? Please explain.

Question 8: The proposed footnote disclosures about going concern uncertainties would result in disclosure of some forward-looking information in

the footnotes. What challenges or consequences, if any, including changes in legal liability for management and its auditors, do you anticipate entities may encounter in complying with the proposed disclosure guidance? Do you foresee any limitations on the type of information that preparers would disclose in the footnotes about going concern uncertainties? Would a higher threshold for disclosures address those concerns?

Question 9: What challenges, if any, could auditors face if the proposed amendments are adopted?

Question 10: Do the expected benefits of the proposed amendments outweigh the incremental costs of applying them?

Disclosure Threshold

Question 11: Under the proposed amendments, disclosures would start at the *more-likely-than-not* or at the *known or probable* threshold as described in paragraph 205-40-50-3.

a. Is the disclosure threshold appropriate? What are the challenges in assessing the likelihood of an entity's potential inability to meet its obligations for purposes of determining whether disclosures are necessary?
b. Are there differences between assessing probability in the context of transactions and assessing probability in the context of the overall state of an entity that are meaningful to determining the appropriateness of a probability model for assessing substantial doubt?
c. Do the proposed amendments adequately contemplate qualitative considerations? Why or why not?
d. Do you believe that the guidance in paragraph 205-40-50-4 about information on how an entity should assess the likelihood of its potential inability to meet its obligations and the implementation guidance within the proposed amendments are helpful and appropriate? Why or why not?
e. Are your views the same for SEC registrants and non-SEC registrants?

Question 12: The proposed amendments would require an entity to assess its potential inability to meet its obligations as they become due for a period of 24 months after the financial statement date. Is this consideration period appropriate? Is it appropriate to distinguish the first 12 months from the second 12 months as proposed in the amendments? Why or why not?

Question 13: Under the proposed amendments, management would be required to distinguish between the mitigating effect of management's plans in and outside the ordinary course of business when evaluating the need for disclosures. Is this distinction relevant to determining if and when disclosures should be made? If

so, explain how management's plans should be considered when defining the two different disclosure thresholds.

Question 14: Do you agree with the definition of *management's plans that are outside the ordinary course of business* as outlined in paragraph 205-40-50-5 and the related implementation guidance?

Question 15: Do you agree with the nature and extent of disclosures outlined in paragraph 205-40-50-7? Should other disclosure principles be included?

Substantial Doubt Determination

Question 16: The proposed amendments define *substantial doubt* as existing when information about existing conditions and events, after considering the mitigating effect of management's plans (including those outside the ordinary course of business), indicates that it is known or probable that an entity will be unable to meet its obligations within a period of 24 months after the financial statement date. Do you agree with this likelihood-based definition for substantial doubt? Do you agree with the 24-month consideration period? Why or why not? Do you anticipate any challenges with this assessment? If so, what are those challenges?

Question 17: Do you agree that an SEC filer's management, in addition to disclosing going concern uncertainties, should be required to evaluate and determine whether there is substantial doubt about an entity's ability to continue as a going concern (going concern presumption) and, if there is substantial doubt, disclose that determination in the footnotes?

Question 18: Do you agree with the Board's decision not to require an entity that is not an SEC filer to evaluate or disclose when there is substantial doubt about its going concern presumption? If not, explain how users of non-SEC filers' financial statements would benefit from a requirement for management to evaluate and disclose substantial doubt.

Question 19: The Board notes in paragraph BC36 that its definition of *substantial doubt* most closely approximates the upper end of the range in the present interpretation of substantial doubt by auditors. Do you agree? Why or why not? Assuming it does represent the upper end of the range of current practice, how many fewer substantial doubt determinations would result from the proposed amendments? If the proposed amendments were finalized by the Board and similar changes were made to auditing standards, would the occurrence of audit opinions with an emphasis-of-matter paragraph discussing going concern uncertainties likewise decrease and be different from what is currently observed? If so, by how much? Is such a decrease an improvement over current practice? Why or why not?

Amendments to the *FASB Accounting Standards Codification*®

Summary of Proposed Amendments to the Accounting Standards Codification

1. The following table provides a summary of the proposed amendments to the Accounting Standards Codification.

Codification Section	**Description of Changes**
Master Glossary	Add the terms *going concern presumption* and *substantial doubt*
Presentation of Financial Statements—Going Concern (Subtopic 205-40)	Add new Subtopic that would establish guidance on disclosures of uncertainties about an entity's going concern presumption

Introduction

2. The Accounting Standards Codification is amended as described in paragraphs 3 and 4. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck out~~. **[For ease of readability, the newly added Subtopic is not underlined.]**

Amendments to Master Glossary

3. Add the following new Master Glossary terms, with a link to transition paragraph 205-40-65-1, as follows:

Going Concern Presumption

The inherent presumption in preparing financial statements under U.S. generally accepted accounting principles that an entity will be able to continue as a going concern; that is, the entity will continue to operate such that it will be able to realize its assets and meet its obligations in the ordinary course of business.

Substantial Doubt

Substantial doubt about an entity's ability to continue as a going concern (**going concern presumption**) exists when information about existing conditions and events, after considering the mitigating effect of all of management's plans (including those outside the ordinary course of business), indicates that it is known or probable that an entity will be unable to meet its obligations as they become due within 24 months after the financial statement date. The term *probable* is used consistently with its use in Topic 450 on contingencies.

Addition of Subtopic 205-40

4. Add Subtopic 205-40, with a link to transition paragraph 205-40-65-1, as follows:

Presentation of Financial Statements—Going Concern

Overview and Background

205-40-05-1 Financial statements are prepared under the inherent presumption that a reporting entity will be able to continue as a going concern; that is, the entity will continue to operate such that it will be able to realize its assets and meet its obligations in the ordinary course of business (the **going concern presumption**).

205-40-05-2 An entity shall prepare financial statements under the going concern presumption until its **liquidation** is imminent in accordance with Subtopic 205-30 on the liquidation basis of accounting. When liquidation is imminent, an entity shall start applying the liquidation basis of accounting. Even before an entity's liquidation is imminent, there may be uncertainties about an entity's going concern presumption. This Subtopic requires an entity to evaluate those uncertainties at each annual and interim reporting period by assessing the entity's potential inability to meet its obligations as they become due within 24 months after the financial statement date, and requires disclosures if certain conditions are met.

Scope and Scope Exceptions

> Entities

205-40-15-1 All entities shall follow the guidance on determining whether disclosures of uncertainties about an entity's **going concern presumption** are necessary and the guidance on the nature and extent of disclosures at each

annual and interim reporting period. In addition, a **Securities and Exchange Commission (SEC) Filer** shall evaluate and determine at each annual and interim reporting period whether there is **substantial doubt** about its going concern presumption and, if there is substantial doubt, disclose that determination in the financial statements.

Disclosure

> Determining Whether Disclosures Are Necessary

205-40-50-1 To determine whether disclosures are necessary, an entity shall assess at each annual and interim reporting period the entity's potential inability to meet its obligations as they become due within 24 months after the financial statement date.

205-40-50-2 In assessing an entity's potential inability to meet its obligations, the entity shall consider all information about conditions and events that exist at the date the **financial statements are issued** (or for a nonpublic entity the date that the **financial statements are available to be issued**).

205-40-50-3 An entity shall provide the disclosures described in paragraph 205-40-50-7 when information about conditions and events indicate either of the following:

a. It is more likely than not that the entity will be unable to meet its obligations within 12 months after the financial statement date without taking actions outside the ordinary course of business (as described in paragraph 205-40-50-5).
b. It is known or probable that the entity will be unable to meet its obligations within 24 months after the financial statement date without taking actions outside the ordinary course of business (as described in paragraph 205-40-50-5).

205-40-50-4 An entity shall assess all relevant information about conditions and events in the aggregate to determine their potential effect on the entity's potential inability to meet its obligations within 24 months after the financial statement date. In assessing the likelihood of its potential inability to meet its obligations, an entity shall consider information about the following conditions and events, among others:

a. Sources of liquidity, including available liquid funds and available access to credit.
b. Funds necessary to maintain operations in the ordinary course of business.
c. Conditional and unconditional obligations due or anticipated within 24 months after the financial statement date.

d. Conditions and events that could adversely affect the entity's ability to meet its obligations. Examples include the anticipated loss of a major customer, the impending maturity of significant debt, or the upcoming expiration of a key patent. See paragraph 205-40-55-3 for additional examples of adverse conditions and events.
e. Conditions and events that could mitigate the entity's potential inability to meet its obligations. Examples include the recent renewal of a major customer contract, a reduction in the costs of raw materials, or an increase in market demand for the entity's products.
f. The effect of management's plans that are in the ordinary course of business. Those plans that are deemed to be within the ordinary course of business shall be considered only if they are likely to be effectively implemented and likely to mitigate the adverse conditions and events. For example, the mitigating effect of cost-cutting measures that are likely to be effectively implemented and likely to successfully reduce costs shall be considered in assessing the likelihood of an entity's potential inability to meet its obligations if such plans are in the ordinary course of business. In contrast, the mitigating effect of management's plans that require actions outside the ordinary course of business (as described in the following paragraph) shall not be considered in assessing the likelihood of the entity's potential inability to meet its obligations in determining the need for disclosures.

> > Management's Plans That Are Outside the Ordinary Course of Business

205-40-50-5 Management's plans that involve actions of a nature, magnitude, or frequency that are inconsistent with actions customary in carrying out an entity's ongoing business activities shall be considered outside the ordinary course of business. Therefore, their mitigating effect shall not be considered in determining whether disclosures are necessary.

205-40-50-6 Whether a certain plan is outside the ordinary course of business is an entity-specific determination. The same plan can be in the ordinary course of business for one entity but outside the ordinary course for another. An entity shall consider the nature, magnitude, and frequency of a plan in light of the entity's ongoing business activities to determine whether it is outside the ordinary course of business. Management's intent in undertaking the plan also shall be considered in the determination. For example, management's plans that are primarily intended to alleviate specific conditions or events that likely would lead to an entity's inability to meet its obligations otherwise generally are outside the ordinary course of business unless they are consistent with actions customary in carrying out the entity's ongoing business activities. Paragraphs 205-40-55-4 through 55-9 further illustrate how management's plans would be considered in an entity's assessment.

> **Nature and Extent of Disclosures**

205-40-50-7 When the disclosure threshold in paragraph 205-40-50-3 is met, an entity shall disclose information that enables users of the financial statements to understand all of the following:

a. Principal conditions and events that give rise to the entity's potential inability to meet its obligations
b. The possible effects those conditions and events could have on the entity
c. Management's evaluation of the significance of those conditions and events
d. Mitigating conditions and events
e. Management's plans that are intended to address the entity's potential inability to meet its obligations.

205-40-50-8 Disclosures may be less extensive in the early stages of an entity's potential inability to meet its obligations because available information may be limited. In subsequent reporting periods, if the entity continues to meet the disclosure threshold, disclosures shall be more extensive as additional information becomes available about previously disclosed conditions and events and about management's plans. Appropriate context and continuity shall be provided in explaining how conditions and events have changed between reporting periods. In the period that an entity no longer meets the disclosure threshold, the entity shall disclose how the principal conditions and events that originally gave rise to the entity's potential inability to meet its obligations have been resolved.

> **Evaluating Whether There Is Substantial Doubt (SEC Filers Only)**

205-40-50-9 An entity that is a **Securities and Exchange Commission (SEC) Filer** also shall evaluate and determine whether there is **substantial doubt** about the entity's **going concern presumption**. The principles in this Subtopic for determining whether disclosures are necessary also shall apply to an entity's evaluation of whether there is substantial doubt. However, when evaluating and determining whether there is substantial doubt, an entity shall consider the effect of all of management's plans that are likely to be effectively implemented and likely to mitigate the adverse conditions and events, including those outside the ordinary course of business.

> > **Disclosure of a Substantial Doubt Determination (SEC Filers Only)**

205-40-50-10 If an entity that is an SEC filer determines that there is substantial doubt about its going concern presumption, the entity shall disclose that determination in its financial statements through the use of the phrase *there is substantial doubt about the entity's ability to continue as a going concern within*

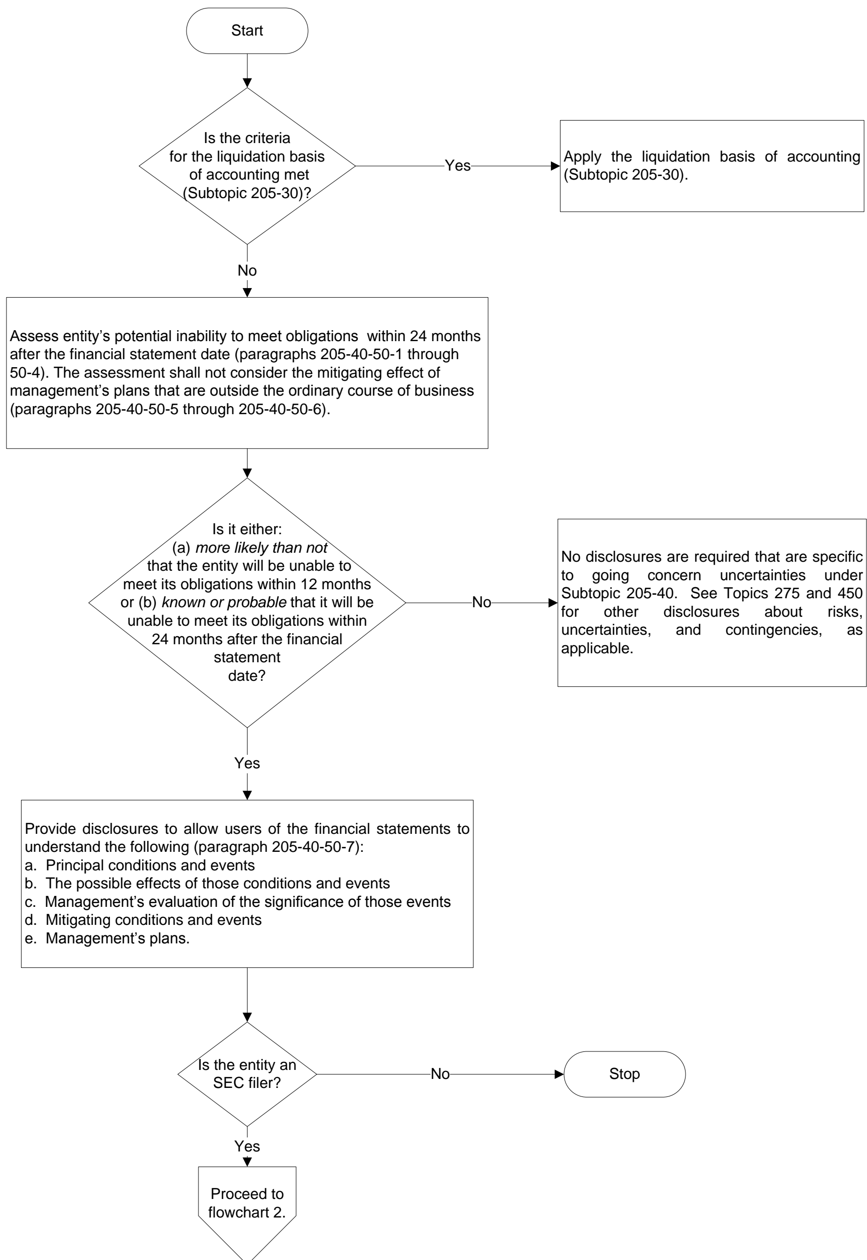
24 months after the financial statement date or similar wording that includes the terms *substantial doubt,* and *ability to continue as a going concern* or *ability to prepare financial statements under the going concern presumption.*

Implementation Guidance and Illustrations

> Implementation Guidance

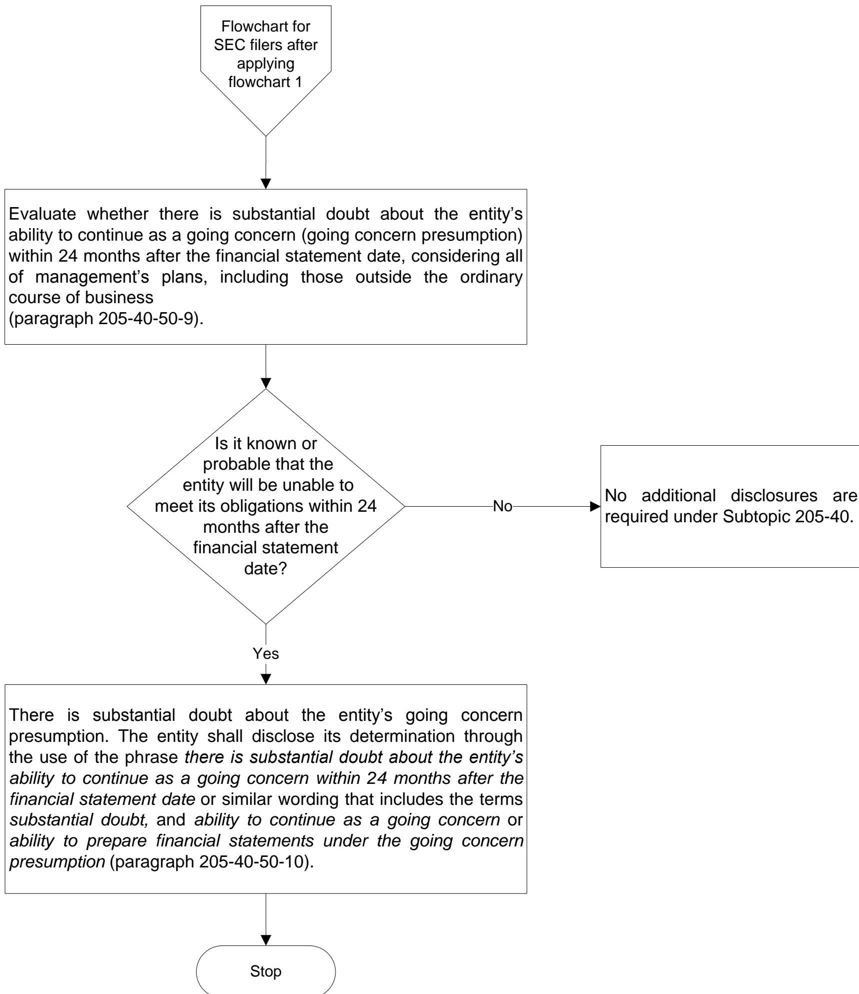
> > Decision Flowchart 1 (All Entities)

205-40-55-1 The following flowchart depicts the decision process that all entities must follow in determining whether disclosures are necessary.


Start
Is the criteria for the liquidation basis of accounting met (Subtopic 205-30)?
Yes
Apply the liquidation basis of accounting (Subtopic 205-30).
No
Assess entity's potential inability to meet obligations within 24 months after the financial statement date (paragraphs 205-40-50-1 through 50-4). The assessment shall not consider the mitigating effect of management's plans that are outside the ordinary course of business (paragraphs 205-40-50-5 through 205-40-50-6).
Is it either: (a) more likely than not that the entity will be unable to meet its obligations within 12 months or (b) known or probable that it will be unable to meet its obligations within 24 months after the financial statement date?
No
No disclosures are required that are specific to going concern uncertainties under Subtopic 205-40. See Topics 275 and 450 for other disclosures about risks, uncertainties, and contingencies, as applicable.
Yes
Provide disclosures to allow users of the financial statements to understand the following (paragraph 205-40-50-7):
a. Principal conditions and events
b. The possible effects of those conditions and events
c. Management's evaluation of the significance of those events
d. Mitigating conditions and events
e. Management's plans.
Is the entity an SEC filer?
No
Stop
Yes
Proceed to flowchart 2.

> > Decision Flowchart 2 (SEC filers Only)

205-40-55-2 The following flowchart depicts the decision process that **Securities and Exchange Commission (SEC) filers** must follow in evaluating and determining whether there is **substantial doubt** about the entity's **going concern presumption**.



> > Examples of Adverse Conditions and Events

205-40-55-3 The following are examples of adverse conditions and events that may result in an entity's potential inability to meet its obligations. The examples are not all inclusive. The existence of one or more of these conditions does not indicate that the disclosure threshold has been met or that there is substantial doubt about the entity's going concern presumption. Similarly, the absence of those conditions does not indicate that the disclosure threshold has not been met or that there is no substantial doubt. The determination of whether disclosures are necessary or whether there is substantial doubt depends on an assessment of all information about conditions and events in the aggregate, including mitigating conditions and events. In assessing the likelihood of its potential inability to meet its obligations, an entity should weigh the likelihood and magnitude of the potential adverse or mitigating effect of the relevant conditions and events.

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

> Illustrations

> > Examples of an Entity's Assessment and Interaction with Management's Plans

205-40-55-4 The following Examples illustrate an entity's assessment of its potential inability to meet its obligations and the interaction of that assessment with management's plans. Each entity should perform the assessment on the basis of its specific facts and circumstances.

> > > Example 1: Determining Whether Disclosures Are Necessary (Debt Matures within 12 Months)

205-40-55-5 Entity A, an SEC filer, has limited access to sources of liquid funds and has a significant portion of its debt due 10 months after the end of its 20X3 fiscal year (the current reporting period). The portion of the debt that is due in 10 months is significant relative to the entity's total assets, current assets, and equity. Entity A's management has developed various strategies to maintain sufficient near-term liquidity. Management has implemented a plan to lower operating expenses through cost-cutting measures in areas such as entertainment, travel, and employee bonuses. Management has previously undertaken similar cost-cutting measures of varying types and scales. Management also has engaged in discussions with its current creditor and other creditors to refinance its debt. The entity has not had to refinance debt in the past five years and expects that failure to refinance the debt could lead the entity to default on this loan payment and potentially on other existing contracts with creditors or third parties. If the entity cannot refinance, it also has implemented a contingency plan to sell a major line of business that represents one-third of its operations. The entity has not made any other plans or secured any other sources of financing to address its liquidity needs.

205-40-55-6 To determine whether disclosure of going concern uncertainties is necessary, along with information about all other relevant conditions and events, Entity A should consider the significance of the maturing debt in light of its available funds necessary to maintain current operations. Additionally, it should assess the effect of the repayment of the debt on its liquidity and, therefore, its potential inability to meet its obligations (the debt and other conditional or unconditional obligations as they become due) within 24 months after the reporting period. For purposes of its determination of whether disclosures are necessary, Entity A also should consider the mitigating effect of its cost-cutting measures because the plan is customary in carrying out its ongoing business activities. Entity A should not consider the mitigating effect of its plan to sell a major line of business because that plan would be considered outside the ordinary course of business on the basis of its infrequency, magnitude, and nature. The plan to refinance the debt may or may not be considered outside the ordinary course of business. In this case, because the debt is significant to the entity's liquidity needs and because the entity does not customarily refinance its debt, the refinancing would likely be considered outside the ordinary course of business. In a different fact pattern, the action may be considered in the ordinary course of business, because, for example, debt may be less significant in relation to its liquidity needs or refinancing may be more common because the entity often takes advantage of the interest rate fluctuations to lower its borrowing costs.

205-40-55-7 If Entity A determines after assessing all of the relevant conditions and events (excluding the mitigating effect of the potential refinancing and sale of a business line) that it is either more likely than not that it will be unable to meet its obligations within 12 months after the reporting period, or known or probable that it will be unable to meet its obligations within 24 months after the reporting period, it should provide disclosures about the related uncertainty and about its plans in accordance with paragraph 205-40-50-7. Entity A then would proceed to the assessment of substantial doubt about its ability to continue as a going concern.

> > > Example 2: Determining Whether Disclosures Are Necessary (Debt Matures within 12 to 24 Months)

205-40-55-8 Assume the same fact pattern as in Example 1, except that a significant portion of Entity A’s debt is due 15 months instead of 10 months after the end of the reporting period. Entity A’s management has the same plans to address its liquidity needs (cutting operating expenses and refinancing the debt or selling a major line of business). In this scenario, along with information about all other existing conditions and events, Entity A should consider the significance of the maturing debt in light of its available funds that are necessary to maintain current operations and it should assess the effect of the repayment of the debt on its potential inability to meet its obligations within 24 months after the end of the reporting period. As in Example 1, in determining the need for disclosures, Entity A should consider the mitigating effect of its cost-cutting measures because the plan is customary in carrying out its ongoing business activities. However, as in Example 1, Entity A should not consider the mitigating effect of refinancing the debt or selling a major line of business in determining whether disclosures are necessary. If Entity A determines after assessing all of the relevant conditions and events (except the mitigating effect of refinancing or sale of line of business) that it is known or probable that it will be unable to meet its obligations within 24 months after the reporting period, it should provide disclosures about the related uncertainty and about its plans in accordance with paragraph 205-40-50-7.

> > > Example 3: Evaluating Whether There Is Substantial Doubt

205-40-55-9 Assume the same fact pattern as in Example 1, and assume that Entity A determines that it has met the disclosure threshold in paragraph 205-40-50-3. Because Entity A determined that it met the initial disclosure threshold and because it is an SEC filer, it also must evaluate and determine whether there is substantial doubt about its going concern presumption. In this evaluation, Entity A should consider the mitigating effect (considering the likelihood that it can be effectively implemented and the likelihood that it can mitigate the adverse conditions and events) of both the cost-cutting measures and its plans to refinance the maturing debt or to sell a major line of business to determine whether it is known or probable that it will be unable to meet its obligations within 24 months after the reporting period. If so, Entity A should disclose, in addition to

the disclosures required by paragraph 205-40-50-7, that there is substantial doubt about its ability to continue as a going concern within 24 months after the reporting period.

Transition and Open Effective Date

> Transition Related to Accounting Standards Update No. 2013-XX, *Presentation of Financial Statements (Topic 205): Disclosures of Uncertainties about an Entity's Going Concern Presumption*

205-40-65-1 The following represents the transition and effective date information for Accounting Standards Update No. 2013-XX, *Presentation of Financial Statements (Topic 205): Disclosures of Uncertainties about an Entity's Going Concern Presumption.* The pending content that links to this paragraph shall be effective prospectively for fiscal years, and interim periods within those years, beginning after [date to be inserted after exposure].

The amendments in this proposed Update were approved for publication by five members of the Financial Accounting Standards Board. Messrs. Buck and Siegel voted against publication of the amendments. Their alternative views are set out at the end of the basis for conclusions.

Members of the Financial Accounting Standards Board:

Leslie F. Seidman, *Chairman*
Daryl E. Buck
Russell G. Golden
Thomas J. Linsmeier
R. Harold Schroeder
Marc A. Siegel
Lawrence W. Smith

Background Information, Basis for Conclusions, and Alternative Views

Introduction

BC1. The following summarizes the Board's considerations in reaching the decisions in this proposed Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

BC2. The proposed amendments would:

a. Require an entity at each annual and interim reporting period to evaluate uncertainties about its going concern presumption (going concern uncertainties) by assessing its potential inability to meet its obligations within 24 months after the financial statement date.
b. Require disclosures about going concern uncertainties in the financial statement footnotes when the entity determines that it has met a certain threshold.
c. Require an entity that is an SEC filer also to evaluate and determine whether there is substantial doubt about its going concern presumption and, if so, disclose that determination in the footnotes.

Background Information

BC3. The Board originally undertook this project to incorporate in U.S. GAAP certain accounting and reporting guidance that originated as auditing standards. In October 2008, the Board issued an Exposure Draft, *Going Concern,* which would have provided entities with guidance on the preparation of financial statements as a going concern and on management's responsibility to evaluate uncertainties about an entity's ability to continue as a going concern. The 2008 Exposure Draft would have required disclosures either when financial statements were not prepared on a going concern basis or when there was substantial doubt about an entity's ability to continue as a going concern. The 2008 Exposure Draft would have carried forward the going concern guidance from the auditing literature subject to several modifications to align the guidance with IFRS.

BC4. The respondents to the 2008 Exposure Draft indicated that certain terminology and thresholds utilized in the proposed guidance needed to be further clarified, such as *going concern* and *substantial doubt*. Respondents also expressed other concerns about the proposal, including potential complexities on the indefinite nature of the proposed time horizon and the proposed guidance on evaluating *all available information about the future.* Furthermore, respondents

highlighted the apparent omission of the disclosures contained in the auditing literature when an auditor's initial substantial doubt concern is alleviated because of management's plans.

BC5. Several respondents indicated that there was a need for guidance about when and how to prepare financial statements using the liquidation basis of accounting. The Board decided to address the liquidation basis of accounting as part of a separate project. The Board issued Accounting Standards Update No. 2013-07, *Presentation of Financial Statements (Topic 205): Liquidation Basis of Accounting,* in April 2013.

BC6. Since the issuance of the 2008 Exposure Draft, the Board has reassessed the objective of the going concern project at different times in response to feedback and developments in other projects, including the project on the liquidation basis of accounting and the project on liquidity and interest rate risk disclosures. In 2010, the Board modified the objective of the going concern project to propose earlier disclosures about going concern uncertainties. The resulting staff draft was not exposed to the public but was reviewed by a group of users, regulators, and auditors who indicated that the revised guidance may not be operable. In 2011, the Board considered but later rejected incorporating going concern uncertainty disclosures in the separate project about liquidity and interest rate risk disclosures. In May 2012, the Board decided to proceed with the project on going concern with the objective of providing an entity and its management with guidance on assessing uncertainties about an entity's going concern presumption and related disclosures.

Reasons for the Proposed Changes

BC7. Under U.S. GAAP, financial statements are prepared under the inherent presumption that a reporting entity will be able to continue as a going concern; that is, the entity will continue to operate such that it will be able to realize its assets and meet its obligations in the ordinary course of business (the going concern presumption). The going concern presumption is critical to financial reporting because it establishes the fundamental basis for measuring and classifying assets and liabilities under U.S. GAAP. Currently, there is no guidance in U.S. GAAP about management's responsibilities in evaluating or disclosing going concern uncertainties. There also is no guidance in U.S. GAAP about when and how going concern uncertainties should be disclosed in an entity's financial statement footnotes. Auditing standards require that an auditor evaluate whether there is substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. Auditing standards also require auditors to assess the possible financial statement effects, including the adequacy of disclosures on uncertainties about an entity's ability to continue as a going concern for a reasonable period of time (the AICPA's AU-C 570 or the PCAOB's AU SEC 341).

BC8. The Board received input through responses to the 2008 Exposure Draft and subsequent fieldwork indicating that the lack of guidance in U.S. GAAP and the varying interpretations of when and how going concern uncertainties should be disclosed under the auditing standards result in diversity in the timing, nature, and extent of existing footnote disclosures. The proposed amendments are intended to provide preparers with guidance in U.S. GAAP on management's responsibilities and on footnote disclosures about going concern uncertainties and, thereby, reduce existing diversity in footnote disclosures. In doing so, the Board believes that the proposed amendments also would improve the timeliness and the quality of footnote disclosures about going concern uncertainties.

BC9. The proposed amendments improve and incorporate into U.S. GAAP many of the principles that are currently in the auditing standards by (a) requiring management to evaluate going concern uncertainties at each annual and interim reporting period (compared with the annual-only assessment performed under AU SEC 341), (b) prescribing a threshold for starting disclosures (compared with a threshold that is not as clearly defined under the auditing standards), (c) requiring a 24-month assessment period after the financial statement date (compared with 12 months under the auditing standards), and (d) providing a threshold for SEC Filers to determine whether there is substantial doubt about an entity's going concern presumption.

BC10. Currently, the SEC's disclosure rules require that an SEC registrant disclose in its management's discussion and analysis (MD&A) information about trends and uncertainties that are reasonably likely to have a material effect on the registrant's liquidity, capital resources, and results of operations (Regulation S-K, Item 303(a)). Additionally, the SEC's regulations mandate disclosures about a registrant's most significant risk factors (Regulation S-K, Item 503(c)). The information disclosed in the MD&A and the disclosure of risk factors can help users in their evaluations of going concern uncertainties. Therefore, the proposed amendments would not present new or incremental information in an SEC registrant's filing as a whole. However, the proposed amendments would provide SEC registrants with guidance in U.S. GAAP about the timing and content of footnote disclosures specific to going concern uncertainties. The Board believes that the introduction of this guidance would reduce diversity in the timing, nature, and extent of footnote disclosures and, in doing so, improve their timeliness and quality.

BC11. During its deliberations, the Board considered the potential redundancies that could be created in an SEC registrant's filing as a result of the proposed amendments. The Board noted that redundancies exist currently whereby certain SEC registrants provide similar and sometimes identical information about going concern uncertainties in the footnotes and in the MD&A, in part because of the overlap in the auditing standards and the disclosures required by SEC's regulations. The proposed amendments would lead to similar redundancies between a public entity's MD&A and its footnotes. In establishing the proposed disclosure threshold, the Board considered this potential

redundancy but ultimately focused on its objective of reducing diversity in the timing, nature, and extent of disclosures in the financial statement footnotes that are appropriately addressed in U.S. GAAP. The Board indicated during its deliberations that clearly defining the timing and content of footnote disclosures may give an SEC's registrant the opportunity to reassess the placement of the disclosures and reduce existing redundancies. The Board did not elaborate on this issue further because it has no authority over the disclosures contained in an SEC registrant's filing outside the core financial statements and related footnotes.

BC12. Entities that are not SEC registrants are not subject to the SEC's disclosure requirements, and their financial statements generally are limited to the core financial statements and the related footnotes. The Board received input indicating that the lack of guidance in U.S. GAAP and the varying interpretations of when and how going concern uncertainties should be disclosed result in diversity in the timing, nature, and extent of existing footnote disclosures provided by these entities about going concern uncertainties. The proposed amendments also would provide entities that are not SEC registrants with guidance on management's responsibilities and disclosure of going concern uncertainties and, thereby, reduce existing diversity. The Board believes that the proposed amendments also would lead to entities that are not SEC registrants providing more timely and more descriptive disclosures about going concern uncertainties than under current practice, which would be beneficial to users of those financial statements.

What Is the Going Concern Presumption?

BC13. Under U.S. GAAP, financial statements are prepared under the presumption that a reporting entity will be able to continue as a going concern; that is, the entity will continue to operate such that it will be able to realize its assets and meet its obligations in the ordinary course of business. This is referred to as the going concern presumption.

BC14. In U.S. GAAP, financial statements are prepared under the going concern presumption until an entity's liquidation is imminent. When liquidation is imminent, an entity would cease using the going concern presumption and would start applying the liquidation basis of accounting as described in Subtopic 205-30. In accordance with Subtopic 205-30, liquidation is imminent when the likelihood is remote that the entity will return from liquidation and either (a) a plan for liquidation is approved by the person or persons with the authority to make such a plan effective and the likelihood is remote that the execution of the plan will be blocked by other parties or (b) a plan for liquidation is being imposed by other forces (for example, involuntary bankruptcy). If a plan for liquidation was specified in an entity's governing documents from its inception (for example, limited-life entities), the entity should apply the liquidation basis of accounting only if the approved plan for liquidation differs from the plan for liquidation that

was specified at its inception in such a way that the entity is forced to dispose of its assets in exchange for consideration that is not commensurate with the fair value of those assets.

BC15. Even before an entity's liquidation is imminent, there may be uncertainties about its ability to continue as a going concern and, therefore, about its going concern presumption (going concern uncertainties). Because the going concern presumption is fundamental in financial reporting, the Board decided that the preparer of the financial statements should have responsibilities under U.S. GAAP for evaluating uncertainties about an entity's going concern presumption. The Board decided that a proper evaluation of such uncertainties would best be achieved by assessing an entity's potential inability to meet its obligations for a period of time after the financial statement date. The Board also received input indicating that this approach is most consistent with how auditors presently evaluate uncertainties about an entity's ability to continue as a going concern under current auditing literature. Other alternatives were considered, including assessing the probability that (a) *liquidation would be imminent* and (b) that existing conditions and events may have a *severe impact* on an entity's ability to realize its assets and discharge its liabilities. The Board acknowledged the merits of each of those alternatives but decided that assessing an entity's potential inability to meet its obligations would be most familiar and understandable and, therefore, the most operable approach.

Determining Whether Disclosures Are Necessary

The Disclosure Threshold

BC16. Under the proposed amendments, an entity would start providing footnote disclosures when it is either (a) *more likely than not* that the entity will be unable to meet its obligations within 12 months after the financial statement date without taking actions outside the ordinary course of business or (b) *known or probable* that the entity will be unable to meet its obligations within 24 months after the financial statement date without taking actions outside the ordinary course of business. In determining whether disclosures are necessary, an entity would assess information about conditions and events that exist at the date the financial statements are issued (or for a nonpublic entity the date that the financial statements are available to be issued). An entity would not consider the mitigating effect of management's plans that are outside the ordinary course of business in determining whether disclosures are necessary.

BC17. With no relevant financial reporting guidance in U.S. GAAP, the Board had to determine the appropriate threshold at which an entity should be required to disclose uncertainties about its ability to continue as a going concern. In doing so, the Board focused on the primary objective of reducing diversity in the timing, nature, and extent of existing footnote disclosures. The Board decided that the disclosure threshold should be high enough to achieve a narrow focus on

significant uncertainties about an entity's going concern presumption. At the same time, the Board did not want the disclosure threshold to be so high that an entity's disclosures of going concern uncertainties in the footnotes would be provided too late to be of any relevance to users of financial statements. Moreover, the Board received feedback that the current diversity in practice is caused in part by the lack of well-defined terminology and thresholds relating to the timing of disclosures within existing auditing standards.

BC18. The Board considered the use of *substantial doubt* as the initial disclosure threshold but decided against it because the Board wanted to separate the disclosure threshold from a term that, according to many users of financial statements, is viewed as an entity being near bankruptcy. The Board believes that substantial doubt as the initial and only disclosure threshold could lead to disclosures being provided so late that the information would no longer be relevant to financial statement users in assessing uncertainties about an entity's going concern presumption (for example, an entity already may have committed to a major restructuring or a liquidation plan by the time disclosures would have been required). The Board also received feedback that a substantial doubt definition that incorporates a likelihood lower than probable (for example, more likely than not), if incorporated into the auditing standards, could lead to an increase in the number of entities that would receive modified opinions from their auditors.

BC19. The Board decided that a new disclosure threshold should be created and that disclosure threshold should be distinguished from the term *substantial doubt.* This way, an entity would disclose going concern uncertainties not only *when* there is substantial doubt about its going concern presumption but also as the entity is *approaching* substantial doubt about its going concern presumption. The Board selected *more likely than not* for the first 12 months and *known or probable* for the entire 24 months because it believes that this disclosure threshold would result in disclosures as an entity is approaching substantial doubt about its going concern presumption and achieve the primary objective of reducing diversity in the timing of disclosures. The Board's intent was not to require entities to start disclosures at a significantly earlier point than under current practice, but rather to standardize the timing of disclosures at the lower (earlier) end of the range under current practice.

BC20. The Board received feedback that there is diversity in the current interpretation of *substantial doubt* among auditors and the related timing of footnote disclosures under current practice. Auditors indicated that they consider more than just the likelihood of a going concern event when deciding whether there is substantial doubt about the entity's ability to continue as going concern. Additionally, some auditors and financial statement users indicated that the use of *probable* as a disclosure threshold would be most consistent with the current practice of disclosing going concern uncertainties. However, other auditors and stakeholders indicated that existing footnote disclosures start sooner than *probable*. The diversity in practice also was mentioned in different forums,

including by certain participants in a 2012 meeting of the Standing Advisory Group of the Public Company Accounting Oversight Board.

BC21. Various academics also have tried to pinpoint the threshold for substantial doubt under current practice. A commonly cited academic paper (Boritz, 1991)[1] noted that a 50 to 70 percent likelihood of an entity being unable to meet its obligations would represent substantial doubt. Another study (Asare, 1992)[2] found that auditors, on average, assign a probability value of 56.56 percent (with a standard deviation of 16.65 percent) as their "minimum threshold value for the likelihood of going concern necessary to issue an unqualified report." The study determined that defining *substantial doubt* could alleviate different interpretations of its meaning. The Board's outreach and research efforts also found differences in views between different stakeholder groups. Generally, the Board learned that financial statement users perceive substantial doubt as a higher probability than auditors as evidenced by the view expressed by many users that substantial doubt means *near bankruptcy*. The range of feedback about substantial doubt and the related timing of disclosures in practice further highlighted for the Board the need to address the existing diversity by introducing a well-understood disclosure threshold.

BC22. After weighing the various considerations outlined above and considering stakeholders' feedback, including feedback received on the 2008 Exposure Draft, the Board decided that the proposed disclosure threshold of *more likely than not* for the first 12 months and *known or probable* for the entire 24 months after the financial statement date would achieve the objective of reducing diversity in the timing of footnote disclosures. The Board also determined that the disclosure threshold would strike the right balance between providing financial statement users with timely information in the footnotes about going concern uncertainties and maintaining a narrow focus on significant (but not all) uncertainties about an entity's going concern presumption within 24 months after the financial statement date.

BC23. In determining the disclosure threshold, the Board also considered *reasonably likely* as a potential alternative. The Board acknowledged that the use of such a threshold that represents a range may be more operable in close-call situations, but it noted that the introduction of any threshold would result in close-call situations regardless of whether it is within a range or a precise point. The Board ultimately decided that the more-likely-than-not and the known or probable threshold would align better with the Board's objective of reducing diversity in the timing and content of disclosures about going concern uncertainties because those thresholds are well understood and applied in other areas of U.S. GAAP.

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[1] J. Efrim Boritz, *The "Going Concern" Assumption: Accounting and Auditing Implications* (Toronto, Canada: The Canadian Institute of Chartered Public Accountants, 1991).

[2] S.K. Asare, "The Auditor's Going Concern Decision: Interaction of Task Variables and the Sequential Processing of Evidence," *The Accounting Review* 67 (April 1992): 319–393.

BC24. Some stakeholders expressed that the more-likely-than-not threshold that is applicable to the first 12 months after the financial statement date requires a level of precision that is not operable because of the difficulty in estimating the likelihood of an entity's potential inability to meet its obligations, especially in close-call situations. Those stakeholders stressed that the disclosure requirements should not be based solely on a likelihood condition, but also on the weighing of relevant factors in each circumstance. The Board provided additional qualitative implementation guidance in the proposed amendments about the information management should assess and examples of conditions or events that an entity should consider. The Board also considered introducing a likelihood range (for example 40 to 60 percent) but decided against it because any likelihood-based threshold, whether within a range or at a precise point, would have close-call situations at the low end of the range. The Board acknowledged that calculating the exact likelihood of an entity's inability to meet its obligations in a future period is inherently impracticable. Therefore, similar to its use in other areas of U.S. GAAP, the more-likely-than-not threshold was intended as a benchmark for determining whether disclosures are required, not as a formula-based likelihood calculation. The Board introduced additional guidance to supplement the probability-based threshold. The Board considered but rejected an indicators-only approach (without a probability threshold) because it decided that approach would not equally achieve the objective of reducing existing diversity in the timing of disclosures.

The Assessment Period

BC25. The Board decided that the assessment period should be within 24 months after the financial statement date. Current auditing literature uses the term *reasonable period of time* and defines it as a period not to exceed one year beyond the date of the financial statements being audited. The Board decided that an assessment period of 12 months is appropriate in most circumstances but may not be long enough in other circumstances to provide users with the necessary information about significant going concern uncertainties that extend beyond 12 months. At the same time, based on feedback received on the 2008 Exposure Draft, the Board did not want to impose an indefinite period of time for the going concern assessment. As a result, the Board decided that the consideration period should not extend beyond 24 months after the financial statement date. Twenty-four months was selected on the basis of stakeholders' feedback that it would be impracticable to evaluate the likelihood of an entity's potential inability to meet its obligations beyond two years. The Board also received feedback that under current practice, some entities already disclose in the footnotes known going concern uncertainties that go beyond one year. Moreover, the Board wanted to acknowledge the practical limitations in reliably predicting an entity's potential inability to meet its obligations beyond 12 months after the financial statement date, the time horizon currently used by auditors.

The Board did so by limiting the more-likely-than-not threshold to the first 12 months and by raising the threshold for disclosures beyond 12 months such that an entity would start disclosures when information about conditions and events indicates that it is known or probable (instead of more likely than not) that the entity will be unable to meet its obligations.

BC26. The Board did not intend to prohibit an entity from considering the potential effect of conditions and events that may occur after 24 months, but it decided that an appropriate time limit was important to make the proposed amendments operable and to maintain the focus of the disclosures on the more significant and nearer term going concern uncertainties. The more distant in the future a going concern uncertainty is, the less predictable the outcome of that uncertainty, and the more options management has to remedy the uncertainty. Therefore, when there are known effects of an existing condition or event that go beyond 24 months, the Board believes that an entity could disclose the related uncertainties in other parts of the financial statements (for example, as part of the loss contingencies, risks and uncertainties, or the debt payable footnote), but the entity should not characterize such disclosures as going concern uncertainties.

Information to Be Assessed

BC27. A recurring theme in the responses to the 2008 Exposure Draft was that the proposed requirement to evaluate *all available information about the future* would be inoperable. Respondents indicated that in combination with the indefinite nature of the proposed assessment period, the proposed requirement would have placed undue cost and burden on preparers and auditors. In response, the Board decided that the assessment should be based on information about conditions and events that exist as of the date that the financial statements are issued or the date that the financial statements are available to be issued. The Board decided that this approach would capture appropriately the type of information necessary to assess uncertainties about an entity's potential inability to meet its obligations as they become due. That approach also would be consistent with how other financial statement estimates and judgments are currently made and would be similar to current auditing standards that require an auditor to base its evaluation on the auditor's knowledge of relevant conditions and events that exist at, or have occurred before, the date of the auditor's report. The Board acknowledged that a detailed analysis may not be necessary if an entity has a history of profitable operations and ready access to financial resources after considering available information about conditions and events. In other cases, management may need to consider a wider range of factors relating to available sources of liquidity, funds necessary to maintain operations in the ordinary course of business, expected cash flows from operations, other obligations whether they are conditional or unconditional, debt repayment schedules, and potential sources of replacement financing before it can satisfy itself that going concern disclosures are not necessary.

BC28. In relation to events after the financial statement date but before the date of issuance, the Board decided that an entity should consider the effects of all such subsequent events. The Board acknowledged that there may be situations in which a condition or event occurs during this period, which would be relevant to an entity's assessment of its potential inability to meet its obligations.

Considering Management's Plans

BC29. In determining whether disclosures are necessary, an entity should consider all conditions and events in the aggregate, including mitigating conditions and events. A question for the Board was whether the potential mitigating effect of management's plans should be considered and, if so, what types of plans should be considered. The Board decided that management's plans that are in the ordinary course of business should be considered because those plans cannot be easily distinguished from other conditions and events in evaluating an entity's potential inability to meet its obligations. For example, management's plans to curtail discretionary travel and entertainment spending to improve operating margins generally would be considered in an entity's cash flow forecasts, along with other market conditions such as an expected increase in raw material prices or insurance costs. Accordingly, the Board decided that the mitigating effect of management's plans that are in the ordinary course of business should be reflected in an entity's assessment of its potential inability to meet its obligations.

BC30. The Board decided, however, that the mitigating effect of management's plans that are outside the ordinary course of business should not be considered in determining whether the footnote disclosures in paragraph 205-40-50-7 are necessary. The Board determined that financial statement users would be best served if they are provided with information in the footnotes about both the unmitigated exposure and the mitigating conditions and events, including management's plans. This would give financial statement users the opportunity to evaluate the likely success of those plans in alleviating an entity's potential inability to meet its obligations. For example, if an entity plans to sell a major line of business to avoid an otherwise likely bankruptcy and those plans are judged as feasible and likely to provide sufficient liquidity to maintain operations for the next 24 months, management may conclude that such plans would alleviate substantial doubt about the entity's likely inability to meet its obligations. In that case, there may not be substantial doubt about the entity's going concern presumption, but nevertheless the Board decided that it would be important to disclose the unmitigated uncertainty as well as management's plans that are outside the ordinary course of business, separately. Otherwise, financial statement footnotes would not include useful information about going concern uncertainties because disclosures would be omitted on the basis of potential mitigating effect of those plans. The Board also noted that this approach is consistent with the existing disclosure practices that are provided on an unmitigated basis—albeit inconsistently—because of the requirement in the auditing literature for the auditor to consider the need for disclosures when

substantial doubt has been alleviated primarily after considering management's plans.

BC31. The Board decided that management's plans should be considered outside the ordinary course of business if they involve actions of a nature, magnitude, or frequency that are inconsistent with actions customary in carrying out an entity's ongoing business activities. Whether a certain plan is outside the ordinary course of business would be an entity-specific determination. The same plan can be in the ordinary course of business for one entity but outside the ordinary course for another. The Board determined that an entity should consider the nature, magnitude, and frequency of a plan in light of the entity's ongoing business activities to determine whether it is outside the ordinary course of business.

BC32. The Board also emphasized in the proposed amendments that management's intent in undertaking the plan is an important factor in determining whether the plan is outside the ordinary course of business. Management's plans that are primarily intended to alleviate specific conditions or events that otherwise would lead to an entity's inability to meet its obligations would generally be outside the ordinary course of business, that is, unless they are consistent with actions customary in carrying out the entity's ongoing business activities. For example, if the intent of the plan is solely to refinance existing debt to take advantage of lower market interest rates or borrow money to fund an acquisition, but the entity otherwise does not need financing to maintain its existing operations for 24 months after the financial statement date, the plan would not be considered outside the ordinary course of business. Conversely, if the primary intent of the refinancing is to maintain sufficient cash to simply maintain an entity's ongoing operations and the entity otherwise does not have ready access to financial resources, the plan would be considered outside the ordinary course of business. Therefore, the same action could be in the ordinary course of business for one entity and outside the ordinary course of business for another. The Board also provided examples in the proposed amendments about how management's plans should be considered in an entity's determination of whether the disclosures in paragraph 205-40-50-7 are necessary.

Disclosure Content

BC33. Consistent with the disclosure considerations outlined in current auditing literature, the proposed amendments would require an entity to disclose sufficient information in the footnotes to enable users to understand the principal events and conditions that give rise to an entity's potential inability to meet its obligations for the consideration period, their possible effects on the entity, and management's plans. The Board decided to utilize many of the specific disclosure provisions within the auditing literature and require them in U.S. GAAP because those provisions meet the Board's objective and because they are familiar to stakeholders. The Board wanted to limit disclosures in the financial

statements to relevant information about significant conditions and events that are specific to going concern uncertainties. Therefore, information about uncertainties that would have a material effect on an entity's liquidity or operations would not be disclosed unless it is more likely than not that the entity will be unable to meet its obligations within 12 months or it is known or probable that the entity will be unable to meet its obligation within 24 months from the financial statement date. The Board acknowledges that the proposed requirement to disclose the possible effects and management's plans could be considered forward looking, but it does not believe that it is any more forward looking than under current practice when an auditor concludes that its initial substantial doubt determination has been alleviated primarily because of management's plans. The Board believes that the proposed disclosures that would be adopted from the auditing literature already represent the minimum possible set of information that would be needed to make the disclosure of going concern uncertainties meaningful.

BC34. The Board also decided that disclosures may be less extensive in early stages of an entity's potential inability to meet its obligations because available information may be limited. In subsequent reporting periods, disclosures would be more extensive as additional information becomes available about the principal conditions and events and about management's plans. For purposes of applying this principle, the Board did not want the *extent* of disclosures to be interpreted as the *length* of disclosures. Rather, an entity may provide more extensive information (for example, when there is more information available) without increasing the length of disclosures. Appropriate context and continuity would be provided in explaining how conditions and events have changed between reporting periods. In the period that an entity no longer meets the disclosure threshold, the entity would disclose how the principal conditions and events that originally gave rise to the entity's potential inability to meet its obligations have been resolved.

Evaluating Whether There Is Substantial Doubt about an Entity's Ability to Continue as a Going Concern

BC35. The Board decided that an SEC filer should evaluate and determine whether there is substantial doubt about its ability to continue as a going concern (going concern presumption) within 24 months from the financial statement date, considering the mitigating effect of all of management's plans including those outside the ordinary course of business. If an SEC filer concludes that there is substantial doubt about its going concern presumption, it also should disclose that determination in the footnotes by using the terms *substantial doubt* and *ability to continue as a going concern* or similar wording. An SEC filer's substantial doubt evaluation and disclosure would be incremental to the proposed footnote disclosure threshold in paragraph 205-40-50-3 that would apply to all entities.

BC36. The Board decided to define *substantial doubt* in U.S. GAAP to reduce problems currently caused by different interpretations of its meaning in the auditing literature. The Board decided that substantial doubt about an entity's going concern presumption should exist when information about conditions and events indicates that it is known or probable that the entity will be unable to meet its obligations within 24 months after the financial statement date, after considering the mitigating effect of all of management's plans. This difference in considering management's plans outside the ordinary course of business would appropriately distinguish the initial disclosure threshold from the substantial doubt assertion, and the Board believes that this definition most closely approximates the upper end of the range in the present interpretation of substantial doubt. Accordingly, if the proposed amendments were adopted by the Board and similar changes were made to auditing standards, the Board expects that there would be a lower incidence of audit opinions with an emphasis of matter discussing going concern than is currently observed in practice. The likelihood threshold of probable is intended to have a consistent meaning with Topic 450, Contingencies.

BC37. The auditing standards for both public and nonpublic entity audits require that auditors evaluate whether there is substantial doubt about an entity's ability to continue as a going concern. Additionally, the securities laws (Section 10A(a)(3) of the Securities Exchange Act of 1934) specifically require that an SEC filer's auditor evaluate "whether there is substantial doubt about the issuer's ability to continue as a going concern for the ensuing fiscal year." The auditing standards also require that an auditor provide an emphasis of matter paragraph in its report when there is substantial doubt about an entity's ability to continue as a going concern and further require that the auditors assess the adequacy of related disclosures in the financial statements.

BC38. The Board decided that an SEC filer should be required to evaluate and determine whether there is substantial doubt because it acknowledges that if a requirement is imposed on auditors in the auditing standards to consider disclosures in the financial statements, then management should be provided with guidance in U.S. GAAP about those disclosures. Furthermore, to improve the timeliness of substantial doubt reporting and to align the consideration period with the one used in determining whether disclosures are necessary, the Board decided that the time horizon for evaluating substantial doubt should be 24 months. The Board decided not to impose the same requirement on non-SEC filers because it received feedback from private company stakeholders that a substantial doubt disclosure would not provide incremental benefits for users of those financial statements. This is because, those stakeholders argued, the proposed disclosures already would provide users with all the relevant information related to uncertainties about an entity's potential inability to meet its obligations (and the extent of disclosures would increase if the entity's situation worsens). Some stakeholders also noted that substantial doubt should not be a consideration in U.S. GAAP for SEC filers. The Board ultimately decided to

introduce and define the term *substantial doubt* in the proposed amendments and propose that SEC filers, but not other entities, evaluate its existence.

BC39. Some stakeholders expressed concern that creating a separate reporting model for SEC filers would not be beneficial to financial statement users. The Board, however, does not view the differing requirement to evaluate and disclose substantial doubt as creating two separate reporting models. The proposed amendments would be principally about disclosures of going concern uncertainties in the financial statement footnotes. All else presumed equal, the footnote disclosures of an SEC filer and non-SEC filer would provide the same information except in substantial doubt situations in which the SEC filer would include an additional sentence in the footnotes that there is substantial doubt about its ability to continue as a going concern. Nevertheless, the Board acknowledges that financial statement users should be educated about the overall disclosure requirements in U.S. GAAP as well as the difference in the reporting of substantial doubt between SEC filers and other entities.

Benefits and Costs

BC40. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC41. The proposed amendments clarify that an entity's management is responsible for evaluating and disclosing in the footnotes uncertainties about the entity's going concern presumption, an inherent presumption that is fundamental in preparing financial statements under U.S. GAAP. The proposed amendments would incorporate elements of the current auditing literature into U.S. GAAP, including some of the methods of assessment, the use of a substantial doubt assertion (for SEC filers), and the nature of disclosures, subject to certain clarifications and improvements. The proposed amendments are intended to provide preparers with guidance in U.S. GAAP on management's responsibilities and on footnote disclosures about going concern uncertainties and, thereby, reduce existing diversity in the timing, nature, and extent of existing footnote disclosures. In doing so, the Board believes that the proposed amendments also

would improve the timeliness and the quality of footnote disclosures about going concern uncertainties, which is an outcome that would be beneficial to users of financial statements.

BC42. Auditors are currently responsible for the assessment of going concern uncertainties; however, according to stakeholders' feedback, preparers also may incur in certain circumstances a considerable amount of time in assisting the auditor with the assessment and in preparing the entity's footnote disclosures. This is true particularly in close-call situations in which the auditor would request that management provide prospective financial information and related support. Thus, the extent of costs in practice varies between preparers. Stakeholders indicated that financially healthy entities incur little to no cost in relation to their assessment of going concern. Other entities, especially those that are possible first-time candidates for footnote disclosures about going concern uncertainties, may incur higher costs.

BC43. The proposed amendments are expected to introduce some new costs to preparers as a result of the requirement for management to assess whether disclosures are required at both annual and interim periods and to SEC filers as a result of the requirement for management to evaluate whether there is substantial doubt about an entity's going concern presumption. Because of the judgments involved, preparers would need to implement and document processes and controls for those assessments. The Board expects that the costs of complying with the proposed amendments would continue to be less for financially healthy entities because there are no new disclosure requirements for those entities. The costs of complying may increase for some entities that are not financially healthy. The extent of the cost increase for those entities would depend on a number of factors, including (a) how much of the cost burden has been borne by the preparer previously, (b) the extent to which the auditor's work would be reduced, and (c) whether the entity is an SEC registrant that would have considered and provided similar information in its MD&A or risk factors. Overall, the Board believes that the cost increase (relative to today) would not be significant for many entities in the long term, because of the offsetting effect that the proposed guidance would have on costs by reducing the inefficiencies and complexities that result currently because of the lack of preparer-specific guidance.

BC44. The Board believes that the current lack of guidance in U.S. GAAP creates unnecessary diversity and complexity because management does not have guidance about footnote disclosures that auditors are required to assess under the auditing literature. The Board believes that the diversity and the complexity created by this atypical relationship between the auditor and the preparer would be reduced by providing preparers with direct and clear principles in U.S. GAAP about management's responsibilities and about footnote disclosures. The proposed amendments would impose certain thresholds and concepts that may be considered complex by certain preparers. The Board

believes that those explicit thresholds and concepts are necessary to ensure that the proposal is operable and to ensure that the proposal achieves the Board's objective of reducing diversity in the timing, nature, and extent of footnote disclosures about going concern uncertainties. On balance, the Board believes that the benefits to users resulting from reduced diversity, and the resulting improvement in the timeliness and quality of footnote disclosures justify the costs of applying the proposed amendments.

Alternative Views

BC45. Two Board members disagree with the issuance of the proposed guidance.

BC46. Mr. Buck objects to the issuance of this proposed Update because of its requirement that an SEC filer's management asserts in the financial statements when there is substantial doubt about a reporting entity's going concern presumption. He understands that the U.S. securities law requires an SEC filer's auditor to assess whether it believes there is substantial doubt about the entity's ability to continue as a going concern. However, he believes that the auditor's legal requirement does not necessitate an explicit assertion by management in the financial statements. In fact, he believes that such an assertion by management would be inherently biased and, thus, would be of little incremental benefit to investors and would not result in an overall improvement to financial reporting.

BC47. Mr. Buck agrees with the proposed amendments to standardize disclosures required by U.S. GAAP that would inform investors about a reporting entity's potential inability to meet its obligations in the ordinary course of business. He also agrees with the proposed Update's requirement that a reporting entity's management must assess the entity's potential inability to meet its obligations to comply with the disclosure guidance. However, Mr. Buck believes that any assertion of substantial doubt, which he understands to be the legal responsibility of an SEC filer's independent auditor, should not be required of management.

BC48. Mr. Siegel believes that the proposed Update would increase complexity in U.S. GAAP and that it would not significantly increase decision-useful information. Therefore, he believes that the benefits of the proposed Update would not justify the costs. While he believes that incorporating an assertion into U.S. GAAP when an entity has substantial doubt about its ability to continue as a going concern and lengthening the auditing literature's 12-month horizon would represent improvements, he is concerned that including two separate disclosure thresholds (an initial disclosure threshold and a separate assertion of substantial

doubt) would be difficult to implement and audit, and that the content of the proposed disclosures would significantly overlap with existing disclosures in SEC regulatory filings.

BC49. Mr. Siegel believes that the proposed Update would improve financial reporting in several areas. First, he agrees with the Board's decision to incorporate into U.S. GAAP for SEC filers management's substantial doubt assertion when a reporting entity concludes that it is probable that it will be unable to meet its obligations within 24 months after the financial statement date. Even though financial statement users understand that management is responsible for an entity's financial statements, there is no guidance today in U.S. GAAP that requires management to assess uncertainties about an entity's potential inability to continue as a going concern. That requirement only exists in auditing literature, and he agrees with the Board's decision to incorporate it into U.S. GAAP. He also agrees with the Board's decision to improve the assessment by eliminating the restriction in the current auditing literature that limits the going concern assessment to 12 months.

BC50. However, Mr. Siegel believes that the proposed Update's inclusion of two separate disclosure thresholds would increase complexity for SEC filers. Specifically, with respect to the initial disclosure threshold, he is concerned that it will be very difficult to assess when it is *more likely than not* that the entity will be unable to meet its obligations within 12 months from the financial statement date, excluding the mitigating effect of management's plans that are outside the ordinary course of business. He believes that there would be significant disagreements between entities and their auditors about when the reporting entity is approaching the more-likely-than-not threshold and just which activities are within the ordinary course of business.

BC51. Furthermore, Mr. Siegel is concerned that when this threshold is met, the disclosures that would be required by the proposed Update would overlap significantly or would be redundant with more than 15 existing disclosure requirements imposed on SEC registrants by the SEC. As one example, he notes that FRC 501.03(a) requires that ". . . the discussion of long-term liquidity and long-term capital resources must address material capital expenditures, significant balloon payments or other payments due on long-term obligations, and other demands or commitments, including any off-balance sheet items, to be incurred beyond the next 12 months, as well as the proposed sources of funding required to satisfy such obligations." When a registrant determines that it meets the initial disclosure threshold, it would be required under paragraph 205-40-50-7 to provide disclosures to enable financial statement users to, among other things, understand principal conditions and events giving rise to the entity's potential inability to meet its obligations and management's plans to address the entity's inability to meet its obligations. He believes that those proposed requirements would overlap significantly with the SEC's requirements and, therefore, investors would receive little incremental information as a result of the proposed disclosures.

BC52. Mr. Siegel agrees with the decision in the proposed Update that SEC filers should disclose in the financial statements that there is substantial doubt about an entity's going concern presumption when the likelihood of the entity's inability to meet its obligations within 24 months after the financial statement date reaches *known or probable.* As stated above, Mr. Siegel also concurs that the consideration period would exceed 12 months, but not to exceed 24 months, from the period end date. He believes that had the Board only proposed those two changes, with disclosures required for all entities at the known or probable threshold, the objectives of the project would have been met and further complexities would have been avoided.

Amendments to the XBRL Taxonomy

The provisions of this Exposure Draft, if finalized as proposed, would require changes to the U.S. GAAP Financial Reporting Taxonomy (UGT). We welcome comments on these proposed changes to the UGT at ASU Taxonomy Changes provided at www.fasb.org. After the FASB has completed its deliberations and issued a final Accounting Standards Update, proposed amendments to the UGT will be made available for public comment at www.fasb.org and finalized as part of the annual release process.